ANTHRACITE CAPITAL INC
Form 10-Q
November 09, 2004

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

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

For the quarterly period ended September 30, 2004

OR

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

For the transition period from: _____ to _____

Commission File Number 001-13937

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.)
40 East 52nd Street, New York, New York	10022
(Address of principal executive offices)	(Zip Code)

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

NOT APPLICABLE
(Former name, former address, and for new 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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

(1) Yes X No

As of November 8, 2004, there were 53,288,972 shares of the registrant's common stock ($.001 par value per share) outstanding.

ANTHRACITE CAPITAL, INC.
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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

Certain statements contained herein constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 with respect to future financial or business performance, strategies or expectations. Forward-looking statements are typically identified by words or phrases such as "trend," "opportunity," "pipeline," "believe," "comfortable," "expect," "anticipate," "current," "intention," "estimate," "position," "assume," "potential," "outlook," "continue," "remain," "maintain," "sustain," "seek," "achieve" and similar expressions, or future or conditional verbs such as "will," "would," "should," "could," "may" or similar expressions. Anthracite Capital, Inc. (the "Company") cautions that forward-looking statements are subject to numerous assumptions, risks and uncertainties, which change over time. Forward-looking statements speak only as of the date they are made, and the Company assumes no duty to and does not undertake to update forward-looking statements. Actual results could differ materially from those anticipated in forward-looking statements and future results could differ materially from historical performance.

In addition to factors previously disclosed in the Company's Securities and Exchange Commission (the "SEC") reports and those identified elsewhere in this press release, the following factors, among others, could cause actual results to differ materially from forward-looking statements or historical performance:

(1) the introduction, withdrawal, success and timing of business initiatives and strategies;
(2) changes in political, economic or industry conditions, the interest rate environment or financial and capital markets, which could result in changes in the value of the Company's assets;
(3) the relative and absolute investment performance and operations of the Company's manager;
(4) the impact of increased competition;
(5) the impact of capital improvement projects;
(6) the impact of future acquisitions or divestitures;
(7) the unfavorable resolution of legal proceedings;
(8) the extent and timing of any share repurchases;
(9) the impact, extent and timing of technological changes and the adequacy of intellectual property protection;
(10) the impact of legislative and regulatory actions and reforms and regulatory, supervisory or enforcement actions of government agencies relating to the Company, BlackRock Financial Management, Inc. (the "Manager") or The PNC Financial Services Group, Inc. ("PNC Bank");
(11) terrorist activities, which may adversely affect the general economy, real estate, financial and capital markets, specific industries, and the Company and the Manager;
(12) the ability of the Manager to attract and retain highly talented professionals;
(13) fluctuations in foreign currency exchange rates; and
(14) the impact of changes to tax legislation and, generally, the tax position of the Company.

Forward-looking statements speak only as of the date they are made. 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 I - FINANCIAL INFORMATION
Item 1. Interim Financial Statements

ANTHRACITE CAPITAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION (UNAUDITED)
(IN THOUSANDS, EXCEPT PER SHARE DATA)

		September 30, 2004
ASSETS		
Cash and cash equivalents		$15,263
Restricted cash equivalents		27,043
Securities available-for-sale, at fair value:		
Subordinated commercial mortgage-backed securities ("CMBS")	$832,533	
Residential mortgage-backed securities ("RMBS")	147,891	
Investment grade securities	793,602	
Total securities available-for-sale		1,774,026
Commercial mortgage loan pools, at amortized cost		1,316,600
Securities held-for-trading, at fair value		256,275
Commercial mortgage loans, net		197,624
Equity investment in Carbon Capital, Inc. ("Carbon I")		44,664
Investments in real estate joint ventures		5,042
Receivable for investments sold		37,031
Other assets		45,906
Total Assets		$3,719,474
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Secured by pledge of subordinated CMBS	$77,080	
Secured by pledge of other securities available-for-sale and restricted cash equivalents	397,467	
Secured by pledge of commercial mortgage loan pools	1,307,537	
Secured by pledge of securities held-for-trading	246,279	
Secured by pledge of investments in real estate joint ventures	-	
Secured by pledge of commercial mortgage loans	89,053	
Collateralized debt obligations ("CDOs")	1,068,156	
Total borrowings		3,185,572
Securities sold, not yet settled		-
Payable for investments purchased		15,671
Distributions payable		15,806
Other liabilities		35,889
Total Liabilities		$3,252,938
Commitments and Contingencies		
Stockholders' Equity:		
Common Stock, par value $0.001 per share; 400,000 shares authorized;		
53,241 shares issued and outstanding in 2004; 49,464 shares issued and outstanding in 2003		53

10% Series B Preferred Stock, liquidation preference $43,942 in 2003	-
9.375% Series C Preferred Stock, liquidation preference $57,500 in 2004 and 2003	55,435
Additional paid-in capital	578,599
Distributions in excess of earnings	(124,103)
Accumulated other comprehensive loss	(43,448)
Total Stockholders' Equity	466,536
Total Liabilities and Stockholders' Equity	$3,719,474

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

ANTHRACITE CAPITAL, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)
(IN THOUSANDS, EXCEPT PER SHARE DATA)

	For the Three Months Ended September 30,	
	2004	2003
Income:		
Interest from securities available-for-sale	$33,611	$34,007
Interest from commercial mortgage loans	2,979	1,190
Interest from commercial mortgage loan pools	13,715	-
Interest from securities held-for-trading	2,738	3,709
Earnings from real estate joint ventures	165	221
Earnings from equity investment	1,979	749
Interest from cash and cash equivalents	165	453
Other income	742	-
Total income	$56,094	$40,329
Expenses:		
Interest	36,343	20,575
Interest - securities held-for-trading	1,016	1,039
Management fee	2,212	2,115
General and administrative expense	886	551
Total expenses	40,457	24,280
Other gain (loss):		
Gain (loss) on sale of securities available-for-sale	2,081	(4,704)
Loss on securities held-for-trading	(1,103)	(28,154)
Foreign currency loss	(114)	-
Loss on impairment of securities	-	(5,412)
Total other gain (loss)	864	(38,270)

Net income (loss)	16,501	(22,221)
Dividends on preferred stock	1,348	2,491
Cost to retire preferred stock in excess of carrying value	-	-
Net income (loss) available to common stockholders	$15,153	$(24,712)
Net income (loss) per common share, basic:	$0.28	$(0.51)
Net income (loss) per common share, diluted:	$0.28	$(0.51)
Weighted average number of shares outstanding:		
Basic	53,212	48,405
Diluted	53,221	48,405

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

ANTHRACITE CAPITAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY (UNAUDITED)
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2004
(IN THOUSANDS)

	Common Stock, Par Value	Series B Preferred Stock	Series C Preferred Stock	Additional Paid-In Capital	Distributions In Excess Of Earnings	Accumulate Other Comprehensi Loss
Balance at January 1, 2004	$49	$33,431	$55,435	$536,333	$(101,635)	$(106,1
Net income					36,895	
Unrealized loss on cash flow hedges						(4,
Reclassification adjustments from cash flow hedges included in net income						4,
Change in net income unrealized gain (loss) on securities						

available-for-sale, net of reclassification adjustment						63,
Other Comprehensive income						
Comprehensive Income						
Dividends declared-common stock					(43,287)	
Dividends on preferred stock					(5,568)	
Conversion of Series B preferred stock to common stock		(9)		9		
Redemption of Series B preferred stock		(33,422)			(10,508)	
Issuance of common stock	4			42,257		
Balance at September 30, 2004	$53	$-	$55,435	$578,599	$(124,103)	$(43,4

DISCLOSURE OF RECLASSIFICATION ADJUSTMENT:

Unrealized holding gain

Reclassification for realized gains previously recorded as unrealized

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

ANTHRACITE CAPITAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
(IN THOUSANDS)

	For the N Months En September 30
Cash flows from operating activities:	
Net income (loss)	$36,
Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities:	

Net sale of trading securities	46,
Net loss on sale of securities	10,
Loss on impairment of securities	
(Discount accretion) premium amortization	(3,5
Non-cash portion of foreign currency loss	
Amortization of CDO issuance costs	1,
Distributions (equity) in earnings in excess of equity (distributions) from Carbon I	1,
Decrease (increase) in other assets	13,
Decrease in other liabilities	(8,1
Net cash provided by operating activities	98,
Cash flows from investing activities:	
Purchase of securities available-for-sale	(310,5
Purchase of commercial loan pools	(22,6
Sale of commercial loan pools	5,
Funding of commercial mortgage loans	(157,9
Repayments received from commercial mortgage loans	23,
(Increase) decrease in restricted cash equivalents	(14,1
Principal payments received on securities available-for-sale	68,
Distributions from joint ventures in excess of earnings	2,
Investment in Carbon I	(17,4
Proceeds from sales of securities available-for-sale	318,
Net payments under hedging securities	(7,1
Net cash used in investing activities	(111,9
Cash flows from financing activities:	
Net increase (decrease) in borrowings	63,
CDO issuance costs	(5,4
Proceeds from issuance of common stock, net of offering costs	42,
Redemption of Series B Preferred Stock	(43,9
Proceeds from issuance of Series C Preferred Stock, net of offering costs	
Dividends paid on common stock	(42,2
Dividends paid on preferred stock	(5,5
Net cash provided by (used in) financing activities	8,
Net (decrease) increase in cash and cash equivalents	(5,5
Cash and cash equivalents, beginning of period	20,
Cash and cash equivalents, end of period	$15,
Supplemental disclosure of cash flow information:	
Interest paid	$66,
Investments purchased not settled	$15,
Investments sold not settled	$37,

Supplemental schedule of non-cash investing and financing activities:
The Company purchased the Controlling Class securities of a REMIC trust during the nine months ended September 30, 2004:

Carrying value of assets acquired	$1,329,777
Liabilities assumed	1,306,724

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

ANTHRACITE CAPITAL, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
(AMOUNTS GIVEN ARE IN THOUSANDS, EXCEPT PER SHARE AND 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 ("REIT") under the Internal Revenue Code of 1986 and, therefore, its income is largely exempt from corporate taxation. The Company commenced operations on March 24, 1998.

The Company's core investment activities focus on investing in below investment grade CMBS where the Company has the right to control the foreclosure/workout process on the underlying loans, and acquiring and originating high yield commercial real estate loans. The Company also manages excess liquidity with a portfolio of investment grade real estate related securities. This portfolio is being reduced over time.

The accompanying September 30, 2004 unaudited consolidated 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 ("GAAP") for complete financial statements. The results for such interim periods are not necessarily indicative of the results to be expected for the year. In the opinion of management, all adjustments (consisting of only normal recurring accruals) considered necessary for a fair presentation of the results for the respective periods have been reflected. These consolidated financial statements should be read in conjunction with the annual audited financial statements and notes thereto included in the Company's annual report on Form 10-K for 2003 filed with the Securities and Exchange Commission.

In preparing the consolidated 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 certain of the Company's mortgage-backed securities and certain other investments.

NOTE 2 NET INCOME (LOSS) PER SHARE

Net income per share is computed in accordance with Statement of Financial Accounting Standards ("SFAS") No. 128, "Earnings Per Share." Basic income per share is calculated by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted income per share is calculated using the weighted average number of common shares outstanding during the period plus the additional dilutive effect, if any, 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, 2004	2003
Numerator:		
Net income (loss) available to common stockholders	$15,153	$(24,712)
Numerator for basic earnings per share	15,153	(24,712)
Numerator for diluted earnings per share	$15,153	$(24,712)
Denominator:		
Denominator for basic earnings per share--weighted average common shares outstanding	53,212,226	48,405,00
Dilutive effect of stock options	8,282	-
Denominator for diluted earnings per share--weighted average common shares outstanding and common share equivalents outstanding	53,220,508	48,405,00
Basic net income (loss) per weighted average common share:	$0.28	$(0.51)
Diluted net income (loss) per weighted average common share and common share equivalents:	$0.28	$(0.51)

Total anti-dilutive stock options excluded from the calculation of net income (loss) per share were 1,390,651 for the three and nine months ended September 30, 2004. Total anti-dilutive stock options excluded from the calculation of net loss per share were 1,407,443 for the three and nine months ended September 30, 2003.

NOTE 3 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, 2004 are summarized as follows:

Security Description	Amortized Cost	Gross Unrealized Gain	
CMBS:			
CMBS interest only securities ("IOs")	$113,390	$4,098	
Investment grade CMBS	350,731	16,150	
Non-investment grade rated subordinated securities	806,706	56,401	

Non-rated subordinated securities	36,842	6,659
Credit tenant lease	25,641	497
Investment grade REIT debt	251,163	15,790
Project loans	24,281	34
Total CMBS	1,608,754	99,629
Single-family RMBS:		
Agency adjustable rate securities	119,285	2
Residential CMOs	1,584	70
Hybrid adjustable rate mortgages ("ARMs")	27,228	3
Total RMBS	148,097	75
Total securities available-for-sale	$1,756,851	$99,704

As of September 30, 2004, an aggregate of $1,747,930 in estimated fair value of the Company's securities available-for-sale was pledged to secure its collateralized borrowings.

On July 1, 2004, the Company reversed its reclassification for $305,785 of RMBS securities from available-for-sale securities back to held-for-trading securities.

As of September 30, 2004, the anticipated weighted average yield to maturity based upon the amortized cost of the subordinated CMBS ("reported yield") was 9.5% per annum. The anticipated reported yield of the Company's investment grade securities available-for-sale was 5.8%. The Company's reported yields on its subordinated CMBS and investment grade 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.

During the nine months ended September 30, 2004 and 2003, the Company sold a portion of its securities available-for-sale for total proceeds of $318,273 and $1,394,664 respectively, resulting in a realized gain (loss) of $857 and $(1,269) for the nine months ended September 30, 2004 and 2003 respectively.

The following table shows the Company's fair value and gross unrealized losses, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at September 30, 2004:

	Less than 12 Months		12 Months or More	

	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
CMBS:				
CMBS IOs	$19,943	$(308)	$3,332	$(575)
Investment grade CMBS	30,633	(171)	99,219	(4,355)
Non-investment grade rated subordinated securities	5,765	(1,479)	191,107	(69,110)
Non-rated subordinated securities	3,718	(26)	3,347	(3,460)
Credit tenant lease	16,277	(719)	-	-
Investment grade REIT debt	60,039	(1,437)	10,660	(207)
Project loans	19,444	(401)	-	-
Total CMBS	155,819	(4,541)	307,665	(77,707)
Single-family RMBS:				
Agency adjustable rate securities	11,856	(179)	-	-
Hybrid ARMs	4,656	(102)	-	-
Total RMBS	16,512	(281)	-	-
Total temporarily impaired securities	$172,331	$(4,822)	$307,665	$(77,707)

In March 2004, the Emerging Issues Task Force ("EITF") reached a consensus on the "recognition" provisions of Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments" ("EITF No. 03-1"). EITF No. 03-1 requires that a loss be recognized for an impairment that is other-than-temporary. A three-step impairment model should be applied to debt securities subject to SFAS No. 115, including those debt securities subject to EITF No. 99-20, "Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets." On September 30, 2004, the FASB issued FASB Staff Position (FSP) EITF No. 03-1-1, "Effective Date of Paragraphs 10-20 of EITF Issue No. 03-1," which delayed the effective date of the recognition provisions of EITF No. 03-1 until the issuance of the final FSP EITF Issue 03-1-a, "Implementation Guidance for the Application of Paragraph 16 of EITF Issue No. 03-1." Until the final FSP is issued, management is not able to evaluate whether the adoption of the "recognition" provisions under such guidance will have a material effect on our results of operations or financial position.

The temporary impairment of the available-for-sale securities results from the fair value of the securities falling below the amortized cost basis. Management possesses both the intent and the ability to hold the securities until the forecasted recovery of amortized cost. As such, management does not believe any of the securities held are other-than-temporarily impaired at September 30, 2004.

As of September 30, 2004, the Company owns 14 different trusts where through its investment in the lowest or non-rated subordinated CMBS of such trusts is in the first loss position. The Company considers the CMBS securities where it maintains the right to control the foreclosure/workout process on the underlying loans its controlling class CMBS ("Controlling Class"). The following table sets forth certain information relating to the aggregate principal balance and payment status of delinquent mortgage loans underlying the Controlling Class CMBS held by the Company as of September 30, 2004. The

underlying collateral related to the Company's investment in commercial mortgage loan pools is also included in the table. See Note 4 of the consolidated financial statements, Commercial Mortgage Loan Pools, for a further description of the Company's investment in commercial mortgage loan pools.

	September 30, 2004		
	Principal	Number of Loans	% of Collatera
Past due 30 days to 60 days	$33,264	11	0.
Past due 60 days to 90 days	57,510	8	0.
Past due 90 days or more	112,248	15	0.
Real estate owned ("REO")	4,083	1	0.
Total delinquent	$207,105	35	1.
Total principal balance	$16,696,851	2,440	

To the extent that the Company's expectation of realized losses on individual loans supporting the CMBS, if any, or such resolutions differ significantly from the Company's original loss estimates, it may be necessary to reduce the projected reported yield on the applicable CMBS investment to better reflect such investment's expected earnings net of expected losses, and write the investment down to its fair value. While realized losses on individual loans may be higher or lower than original estimates, the Company currently believes its aggregate loss estimates and reported yields are appropriate on all investments.

NOTE 4 COMMERCIAL MORTGAGE LOAN POOLS

During the second quarter of 2004, the Company acquired subordinated CMBS in a trust establishing a Controlling Class interest. As the Controlling Class holder, the Company has the ability to control dispositions or workouts of any defaulted loans in this trust. The Company negotiated for and obtained a greater degree of discretion over the disposition of the commercial mortgage loans than is typically granted to the special servicer. As a result of this expanded discretion, FASB Interpretation No. 46, "Consolidation of Variable Interest Entities" (revised December 2003) ("FIN 46R") requires the Company to consolidate the net assets and results of operations of the trust.

The CMBS securities acquired by the Company have a par value of $41,495 with $13,890 not rated and the balance rated BBB- to B-. During the third quarter the Company sold the BBB- rated security, which had the impact of increasing the borrowings for the commercial loan pool by $5,848. As of September 30, 2004, the CMBS securities owned by the Company have a par value of $35,495.

The debt associated with the REMIC trust is non-recourse to the Company, and is secured only by the commercial mortgage loan pools. The consolidation of the REMIC trust results in an increase in the Company's total debt to capital ratio from 4.0:1 to 6.8:1, but has no effect on the Company's recourse debt to

capital ratio. The Company received authorization from its lenders to permit debt to capital ratios in excess of existing covenants. For income recognition purposes, the Company considers the unrated commercial mortgage loans in the pool as a single asset reflecting the credit assumptions made in establishing loss adjusted yields for Controlling Class securities.

Approximately 45% of the par amount of the commercial mortgage loan pool is comprised of loans that are shadow rated A2 or better by Moody's Investors Service and AA by Standard & Poor's. The Company has taken into account the credit quality of the underlying loans in formulating its loss assumptions. Credit losses assumed on the entire pool are 1.40% of the principal balance, or 2.53% of the unrated principal balance. The Company accounts for the unrated commercial mortgage loans in the pool as a single asset based on this common credit risk characteristic.

Over the life of the commercial mortgage loan pools, the Company reviews and updates its loss assumptions to determine the impact on expected cash flows to be collected. A decrease in estimated cash flows will reduce the amount of interest income recognized in future periods and may result in a loan loss reserve depending upon the severity of the cash flow reductions. An increase in estimated cash flows will first reduce the loan loss reserve and any additional cash will increase the amount of interest income recorded in future periods.

NOTE 5 SECURITIES HELD-FOR-TRADING

Securities classified as held-for-trading include investments that the Company intends to hold for a short period of time, usually less than one year. This classification generally includes highly liquid securities that the Company acquires on a hedged basis to earn net interest income until the Company redeploys that capital into credit sensitive commercial real estate opportunities.

On July 1, 2004, the Company reversed its reclassification for $305,785 of RMBS securities from available-for-sale securities back to held-for-trading securities.

For the nine months ended September 30, 2004, losses on securities held-for-trading in the consolidated statement of operations of $11,133 are attributable to the Company's repositioning and reduction of its RMBS portfolio and associated hedges. The Company's longstanding policy has been to maintain limits on the exposure of the Company's equity to changes in long-term rates as well as the exposure of earnings to changes in short-term funding rates.

NOTE 6 COMMON STOCK

On March 11, 2004, the Company declared dividends to its common stockholders of $0.28 per share, payable on April 30, 2004 to stockholders of record on March 31, 2004.

On May 25, 2004, the Company declared dividends to its common stockholders of $0.28 per share, paid on August 2, 2004 to stockholders of record on June 15, 2004.

On September 15, 2004, the Company declared dividends to its common stockholders of $0.28 per share paid on November 1, 2004 to stockholders of record on September 30, 2004.

For the nine months ended September 30, 2004, the Company issued 1,077,102 shares of common stock of the Company, par value $0.001 per share (the "Common

Stock"), under its Dividend Reinvestment and Stock Purchase Plan (the "Dividend Reinvestment Plan"). Net proceeds to the Company were approximately $12,606. For the nine months ended September 30, 2003, the Company issued 1,355,006 shares of Common Stock under its Dividend Reinvestment Plan. Net proceeds to the Company were approximately $15,113.

For the three and nine months ended September 30, 2004, the Company issued 253,800 shares of Common Stock under a sale agency agreement with Brinson Patrick Securities Corporation. Net proceeds to the Company were approximately $2,761.

For the three and nine months ended September 30, 2003, the Company issued 45,000 shares of Common Stock under a sale agency agreement with Brinson Patrick Securities Corporation. Net proceeds to the Company were approximately $497.

During the first quarter of 2004, the Company suspended its Dividend Reinvestment Plan for all investments after March 26, 2004, and for all future investment dates. During the second quarter of 2004, the dividend reinvestment portion of the Dividend Reinvestment Plan was reinstated for all dividend payments made after August 2, 2004, and for all future dividend payment dates with a discount of 2%. The optional cash purchase portion of the Dividend Reinvestment Plan remains suspended; however, it may be resumed at any time.

On June 30, 2004, the Company completed a follow-on offering of 2,100,000 shares of its Common Stock in an underwritten public offering. The net proceeds to the Company (after deducting underwriting fees and expenses) were approximately $23,184. The Company had granted the underwriters an option, exercisable for 30 days, to purchase up to 315,000 additional shares of Common Stock to cover over-allotments. This option was exercised on July 6, 2004 and resulted in net proceeds to the Company of approximately $3,478.

NOTE 7 PREFERRED STOCK

At the end of the first quarter of 2004, the Board of Directors approved the Company's decision to redeem its Series B Preferred Stock, $0.001 par value per share ("Series B Preferred Stock"). The second quarter of 2004 earnings includes a charge of $0.21 per share for the redemption of the Company's Series B Preferred Stock that was reported as a charge to income in the initial first quarter 2004 earnings release but was subsequently moved to the second quarter to coincide with the timing of the actual redemption payment as reported on May 11, 2004. The Series B Preferred Stock was redeemed on May 6, 2004.

NOTE 8 TRANSACTIONS WITH AFFILIATES

The Company is managed pursuant to a management agreement, dated March 27, 1998, between the Company and the Manager (the "Management Agreement"), a majority owned indirect subsidiary of PNC Bank and the employer of certain directors and all of the officers of the Company, under which the Manager is responsible for the day-to-day operations of the Company and performs such services and activities relating to the assets and operations of the Company as may be appropriate. On March 25, 2002, the Management Agreement was extended for one year through March 27, 2003, with the approval of the unaffiliated directors, on terms similar to the prior agreement with the following changes: (i) the incentive fee calculation would be based on GAAP earnings instead of funds from operations, (ii) the removal of the four-year period to value the Management Agreement in the event of termination and (iii) subsequent renewal periods of the Management Agreement would be for one year instead of two years. The Board of Directors of the Company was advised by Houlihan Lokey Howard & Zukin Financial Advisors, Inc., a national investment banking and financial

advisory firm, in the renewal process.

On March 6, 2003, the unaffiliated directors approved an extension of the Management Agreement from its expiration of March 27, 2003 for one year through March 31, 2004. The terms of the renewed agreement were similar to the prior agreement except for the incentive fee calculation which would provide for a rolling four-quarter high watermark rather than a quarterly calculation. In determining the rolling four-quarter high watermark, the Company would calculate the incentive fee based upon the current and prior three quarters' net income. The Manager would be paid an incentive fee in the current quarter if the Yearly Incentive Fee, as defined, was greater than what was paid to the Manager in the prior three quarters cumulatively. The Company phased in the rolling four-quarter high watermark commencing with the second quarter of 2003. Calculation of the incentive fee was based on GAAP and adjusted to exclude special one-time events pursuant to changes in GAAP accounting pronouncements after discussion between the Manager and the unaffiliated directors. The incentive fee threshold did not change. The high watermark provided for the Manager to be paid 25% of the amount of earnings (calculated in accordance with GAAP) per share that exceeds the product of the adjusted issue price of the Company's Common Stock per share and the greater of 9.5% or 350 basis points over the ten-year Treasury note.

The Management Agreement was further extended for one year from March 31, 2004 through March 31, 2005. The base management fee was revised to equal 2% of the quarterly average total stockholders' equity for the applicable quarter. The incentive fee was revised to be 25% of the amount of earnings (calculated in accordance with GAAP) per share that exceeds the product of the adjusted issue price of the Company's Common Stock per share ($11.37 as of September 30, 2004) and the greater of 8.5% or 400 basis points over the ten-year Treasury note.

During the year ended December 31, 2003 and for the three months ended March 31, 2004, the Company paid 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 was 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+. During the third quarter of 2003, the Manager agreed to reduce the management fees by 20% from its calculated amount for the third and fourth quarter of 2003 and the first quarter of 2004. This revision resulted in $1,046 in savings to the Company during 2003 and $532 for the three months ended March 31, 2004, respectively.

The Company incurred $2,212 and $6,505 in base management fees in accordance with the terms of the Management Agreement for the three and nine months ended September 30, 2004, respectively, and $2,115 and $7,341 for the three and nine months ended September 30, 2003, respectively. In accordance with the provisions of the Management Agreement, the Company recorded reimbursements to the Manager of $54 for certain expenses incurred on behalf of the Company for the nine months ended September 30, 2004, and $11 and $29 for the three and nine months ended September 30, 2003, respectively, which are included in general and administrative expense on the accompanying consolidated statements of operations.

Pursuant to the March 25, 2002 one-year Management Agreement extension, the incentive fee was based on 25% of earnings (calculated in accordance with GAAP) of the Company. For purposes of calculating the incentive fee during 2002, the cumulative transition adjustment of $6,327 resulting from the Company's adoption of SFAS No. 142, "Goodwill and Other Intangible Assets" was excluded from earnings in its entirety and included in the calculation of future incentive fees using an amortization period of three years. The Company did not incur incentive fees for the three and nine months ended September 30, 2004 and 2003.

The Company has an administration agreement with the Manager. Under the terms of the administration agreement, the Manager provides financial reporting, audit coordination and accounting oversight services to the Company. The agreement can be cancelled upon 60-day written notice by either party. The Company pays the Manager a monthly administrative fee at an annual rate of 0.06% of the first $125,000 of average net assets, 0.04% of the next $125,000 of average net assets and 0.03% of average net assets in excess of $250,000 subject to a minimum annual fee of $120. For the three and nine months ended September 30, 2004, the Company paid administrative fees of $43 and $129, respectively, and $44 and $130 for the three and nine months ended September 30, 2003, respectively, which are included in general and administrative expense on the accompanying consolidated statements of operations.

The Company entered into a $50,000 commitment to acquire shares in Carbon I, a private commercial real estate income opportunity fund managed by the Manager. The Carbon I investment period ended on July 12, 2004 and the Company's investment in Carbon I as of September 30, 2004 was $44,664. The Company does not incur any additional management or incentive fees to the Manager as a result of its investment in Carbon I. On September 30, 2004, the Company owned 19.8% of the outstanding shares in Carbon I.

On October 13, 2004, the Company entered into a commitment of up to $30,000 to acquire shares in Carbon Capital II, Inc. ("Carbon II"), a private commercial real estate income opportunity fund managed by the Manager. The Company may commit up to the lower of 20% of the total of Carbon II's capital commitments or $100,000. The Company does not incur any additional management or incentive fees to the Manager as a result of its investment in Carbon II. The Company's unaffiliated directors approved this transaction in September of 2004.

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

During 2000, the Company completed the acquisition of CORE Cap, Inc. At the time of the CORE Cap, Inc. acquisition, the Manager agreed to pay GMAC (CORE Cap, Inc.'s external advisor) $12,500 over a ten-year period ("Installment Payment") to purchase the right to manage the CORE Cap, Inc. assets under the existing management contract ("GMAC Contract"). The GMAC Contract had to be terminated in order to allow the Company to complete the merger, as the Company's management agreement with the Manager did not provide for multiple managers. As a result the Manager offered to buy-out the GMAC Contract as the Manager estimated it would receive incremental fees above and beyond the Installment Payment, and thus was willing to pay for, and separately negotiate, the termination of the GMAC Contract. Accordingly, the value of the Installment Payment was not considered in the Company's allocation of its purchase price to the net assets acquired in the acquisition of CORE Cap, Inc. The Company agreed that should the Management Agreement with its Manager be terminated, not renewed or not extended for any reason other than for cause, the Company would pay to the Manager an amount equal to the Installment Payment less the sum of all payments made by the Manager to GMAC. As of September 30, 2004, the Installment Payment would be $6,500 payable over six years. The Company does not accrue for this contingent liability.

NOTE 9 STOCK OPTIONS

On May 25, 2004, the Company granted stock options to each of its unaffiliated directors with an exercise price equal to the closing price of the Common Stock

on the New York Stock Exchange on such date (or $11.81). The options vested immediately upon grant. The fair value of the options granted is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions.

	May 25, 2004
Estimated volatility	22.6%
Expected life	7 years
Risk-free interest rate	1.2%
Expected dividend yield	9.5%

The fair value of the options granted on May 25, 2004 was negligible. There were no options granted in 2003.

NOTE 10 BORROWINGS

Certain information with respect to the Company's collateralized borrowings at September 30, 2004 is summarized as follows:

	Lines of Credit and Term Loans	Reverse Repurchase Agreements	Collateralized Debt Obligations	Commercial Mortgage Loan Pools
Outstanding borrowings	$134,124*	$684,307	$1,068,156	$1,298,985
Weighted average borrowing rate	3.19%	1.95%	6.07%	3.76%
Weighted average remaining maturity	315 days	22 days	2,936 days	2,674 days
Estimated fair value of assets pledged	$180,074	$751,501	$1,204,912	$1,316,600

* $15,504 of the line of credit borrowings are secured by CDO debt of the Company with a par of $ Company chose not to sell at the time of issuance.

At September 30, 2004, the Company's collateralized borrowings had the following remaining maturities:

	Lines of Credit and Term Loans	Reverse Repurchase Agreements	Collateralized Debt Obligations	Commercial Mortgage Loan Pools
Within 30 days	$ -	$681,604	$ -	$ -
31 to 59 days	-	-	-	-
Over 60 days	134,124	2,703	1,068,156	1,298,985
	$134,124	$684,307	$1,068,156	$1,298,985

In July 2004, the Company issued a bond with a par of $12,850 from its CDO II. Before issuing this security, the Company amended the indenture to reduce the coupon from 9.0% to 7.6%. As a result of this issuance, the total cost of funds

on a fully hedged basis for CDO II rose from 5.7% to 5.8%.

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 11 DERIVATIVE INSTRUMENTS

The Company accounts for its derivative investments under 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. 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.

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.

On July 6, 2004, interest rate swaps with a notional of $264,000 that were classified as trading derivatives were redesignated as cash flow hedges of borrowings under reverse repurchase agreements. The reclassification was based on the Company's intent with respect to these derivatives with the principle objective of generating returns from other than short-term pricing differences.

As of September 30, 2004, the Company had interest rate swaps with notional amounts aggregating $1,215,092 that were designated as cash flow hedges of borrowings under reverse repurchase agreements. Cash flow hedges with a fair value of $8,042 are included in other assets on the consolidated statement of financial condition, and cash flow hedges with a fair value of $(26,223) are included in other liabilities on the consolidated statement of financial condition. For the nine months ended September 30, 2004, the net change in the fair value of the interest rate swaps was a decrease of $8,683, of which $1,130 was deemed ineffective and is included as an increase to interest expense, $4,696 was recorded as a decrease of OCI and $2,856 was included as an addition to loss on trading securities due to a period of ineffectiveness. As of September 30, 2004, the $1,215,092 notional of swaps that was designated as cash flow hedges had a weighted average remaining term of 7.57 years.

As of September 30, 2004, the Company had interest rate swaps with notional amounts aggregating $239,445 designated as trading derivatives. Trading derivatives with a fair value of $104 are included in other assets on the consolidated statement of financial condition and trading derivatives with a fair value of $(69) are included in other liabilities on the consolidated statement of financial condition. For the nine months ended September 30, 2004, the change in fair value for the trading derivatives was a decrease of $160 and is included as an addition to loss on securities held-for-trading in the

consolidated statements of operations. As of September 30, 2004, the $239,445 notional of swaps that was designated as trading derivatives had a weighted average remaining term of 7.92 years.

Occasionally, counterparties will require the Company or the Company will require counterparties to provide collateral for the interest rate swap agreements in the form of margin deposits. Net deposits are recorded as a component of either other assets or other liabilities. Should the counterparty fail to return deposits paid, the Company would be at risk for the fair market value of that asset. At September 30, 2004 and December 31, 2003, the balance of such net margin deposits owed to counterparties as collateral under these agreements totaled $8,843 and $10,445, respectively, and are recorded in restricted cash on the accompanying consolidated statements of financial condition.

The contracts identified in the remaining portion of this note have been entered into to limit the Company's mark to market exposure to long-term interest rates.

Additionally, the Company had a forward London Interbank Offered Rate ("LIBOR") cap with a notional amount of $85,000 and a fair value at September 30, 2004 of $739 which is included in other assets, and the change in fair value related to this derivative is included as a component of loss on securities held-for-trading in the consolidated statements of operations.

NOTE 12 SUBSEQUENT EVENT

On October 21, 2004, the Company priced a CDO secured by a portfolio of below investment grade CMBS ("Collateral"). The transaction will be accounted for as a sale in accordance with SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." The Company will receive total consideration of $158,032 consisting of net cash of $121,479 and CDO securities with a fair market value of $36,553 in exchange for the Collateral. The Collateral was carried at a fair market value of $109,933 on the Company's September 30, 2004 consolidated statement of financial condition based on price quotes received from third parties. The Company expects to recognize a gain of approximately $16,636 when the transaction closes in November 2004.

The fair market value of the securities received in exchange for the collateral includes the retention of 100% of the equity of the CDO. The value of the equity investment was provided by a third party and was established using a 70.5% discount rate on the cash flows computed before adjusting for credit loss assumptions. Income will be recorded from this equity investment on a loss-adjusted basis using a yield of 53.1%. The equity investment will be classified as available for sale on the Company's statement of financial condition.

The recognition of this gain increases the likelihood that the Company will incur incentive fee expense commencing in the fourth quarter of 2004. Incentive fees are computed using net income based on a rolling four-quarter period (see further discussion in Note 8 of the consolidated financial statements). The recognition of the gain will increase the income included in the rolling four-quarter period until the quarter ended December 31, 2005.

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

All dollar figures expressed herein are expressed in thousands, except share or per share amounts or as otherwise noted.

I. GENERAL

Anthracite Capital, Inc. (the "Company"), a Maryland corporation, is a real estate finance company that invests in high yielding commercial real estate debt. The Company commenced operations on March 24, 1998.

The Company's primary focus is to invest in a diverse portfolio of commercial real estate loans and commercial mortgage-backed securities ("CMBS"). The CMBS that the Company purchases are fixed income instruments similar to bonds which carry an interest coupon and stated principal. The cash flow used to pay the interest and principal on the CMBS comes from a designated pool of first mortgage loans on commercial real estate (the "Underlying Loans"). The Underlying Loans are usually originated by commercial banks or investment banks and are secured by a first mortgage on office buildings, retail centers, apartment buildings, hotels and other types of commercial real estate. A typical loan pool may contain several hundred loans with principal amounts of as little as $1,000 to over $100,000. The pooling concept also allows for significant geographic diversification. Converting loans into CMBS in this fashion allows an investor to purchase these securities in global capital markets and to participate in the commercial real estate sector with significant diversification among property types, sizes and locations in one fixed income investment.

The type of CMBS issued from a typical loan pool is generally broken down by credit rating. The highest rated CMBS will receive payments of principal first and is therefore least exposed to the credit performance of the Underlying Loan. These securities will carry a credit rating of "AAA" and will be issued with a principal amount that represents some portion of the total principal amount of the Underlying Loan pool.

The CMBS that receive principal payments last are generally rated below investment grade (BB+ or lower.) As the last to receive principal these CMBS are also the first to absorb any credit losses incurred in the Underlying Loan pool. The principal amount of these below investment grade classes generally represents 3.0-5.0% of the principal of the Underlying Loan pools. The investor that owns the lowest rated, or non-rated CMBS class is designated as the controlling class representative for the underlying loan pool. This designation allows the holder to assert a significant degree of control over any workouts or foreclosures of defaulted Underlying Loans. These securities are generally issued with a high yield to compensate for the credit risk inherent in owning the CMBS class which is the first to absorb losses.

The Company's high yield commercial real estate loan strategy is based on a similar concept of investing in a portion of the principal and interest of a specific loan instead of a pool of loans as in CMBS. In this case the principal amount of a single loan is separated into a senior interest ("A note") and a junior interest ("B note"). Prior to a borrower default, the A note and the B note receive principal and interest pari passu; however after a borrower default, the A note would receive its principal and interest first and the B note would absorb the credit losses that occur, if any, up to the full amount of its principal. The B note holder generally has certain rights to control workouts or foreclosures. The Company invests in B notes as they provide higher yields with control of dispositions.

The Company also invests in mezzanine loans on commercial real estate. Mezzanine loans are secured by the ownership interests in an entity that owns real estate. These loans are generally subordinated to a first mortgage and would absorb a credit loss prior to the senior mortgage holder.

The Company believes that the trend toward highly structured investment products requires significant expertise in traditional real estate

underwriting as well as in the capital markets. Through its external management contract with BlackRock Financial Management, Inc., the Company can source and manage more opportunities by taking advantage of a unique platform that combines these two disciplines.

The Company's common stock is traded on the New York Stock Exchange under the symbol "AHR." The Company's primary long-term objective is to distribute consistent dividends supported by earnings. The Company establishes its dividend by analyzing the long-term sustainability of earnings given existing market conditions and the current composition of its portfolio. This includes an analysis of the Company's credit loss assumptions, general level of interest rates and projected hedging costs.

The Company is managed by BlackRock Financial Management, Inc. (the "Manager"), a subsidiary of BlackRock, Inc., a publicly traded (NYSE: BLK) asset management company with approximately $323,500,000 of assets under management as of September 30, 2004.

During the third quarter of 2004, the Company completed its repositioning into commercial real estate assets. As of September 30, 2004, CMBS and commercial real estate loans represent 89% of portfolio assets while residential mortgage-backed securities ("RMBS") represent 11%. During the quarter, the Company acquired commercial real estate assets with a market value of $194,641, comprised of $56,662 of below investment grade CMBS, $10,608 of investment grade CMBS, $12,968 of investment grade REIT debt and $118,403 of high yield commercial real estate loans. In October 2004, the Company acquired an additional $108,509 of commercial real estate assets.

The following table illustrates the mix of the Company's asset types as of September 30, 2004 and December 31, 2003:

	Carrying Value as of		
	September 30, 2004		December 31,
	Amount	%	Amount
Commercial real estate securities	$1,626,135	45.3%	$1,393,010
Commercial mortgage loan pools	1,316,600	36.6	-
Commercial real estate loans(1)	247,330	6.9	97,984
Residential mortgage-backed securities(2)	396,140	11.0	627,166
Other assets	8,026	0.2	-
Total	$3,594,231	100.0%	$2,118,160

(1) Includes real estate joint ventures and equity investments.
(2) Net of RMBS securities sold, not yet settled

As of September 30, 2004, the Company owns 14 different trusts where it is in the first loss position and is designated as the controlling class representative by owning the lowest rate or non-rated CMBS class. The Company considers the CMBS securities where it maintains the right to control the foreclosure/workout process on the underlying loans its controlling class CMBS ("Controlling Class"). The Company divides its below investment grade CMBS investment activity into two portfolios; Controlling Class CMBS and other below investment grade CMBS.

COMMERCIAL MORTGAGE LOANS POOLS AND COMMERCIAL REAL ESTATE SECURITIES

PORTFOLIO ACTIVITY

During the second quarter of 2004, the Company acquired subordinated CMBS in a trust establishing a Controlling Class interest. As the Controlling Class holder, the Company has the ability to control dispositions or workouts of any defaulted loans in this trust. The Company negotiated for and obtained a greater degree of discretion over the disposition of the commercial mortgage loans than is typically granted to the special servicer. As a result of this expanded discretion, FASB interpretation No. 46, "Consolidation of Variable Interest Entities" (revised December 2003) ("FIN 46R") requires the Company to consolidate the net assets and results of operations of the trust.

The CMBS securities acquired by the Company have a par value of $41,495 with $13,890 not rated and the balance rated BBB- to B-. During the third quarter the Company sold the BBB- rated security, which had the impact of increasing the borrowings for the commercial loan pool by $5,848. As of September 30, 2004, the CMBS securities owned by the Company have a par value of $35,495.

The debt associated with the REMIC trust is non-recourse to the Company, and is secured only by the commercial mortgage loan pools. The consolidation of the REMIC trust results in an increase in the Company's total debt to capital ratio from 4.0:1 to 6.8:1, but has no effect on the Company's recourse debt to capital ratio. The Company received authorization from its lenders to permit debt to capital ratios in excess of existing covenants. For income recognition purposes, the Company considers the unrated commercial mortgage loans in the pool as a single asset reflecting the credit assumptions made in establishing loss adjusted yields for Controlling Class securities.

Approximately 45% of the par amount of the commercial mortgage loan pool is comprised of loans that are shadow rated A2 or better by Moody's Investors Service and AA by Standard & Poor's. The Company has taken into account the credit quality of the underlying loans in formulating its loss assumptions. Credit losses assumed on the entire pool are 1.40% of the principal balance, or 2.53% of the unrated principal balance. The Company accounts for the unrated commercial mortgage loans in the pool as a single asset based on this common credit risk characteristic.

The Company continues to increase its investments in commercial real estate securities. Commercial real estate securities include CMBS and investment grade real estate investment trust ("REIT") debt. During the nine months ended September 30, 2004, the Company increased its commercial real estate securities portfolio by 17% from $1,393,010 to $1,626,135. This increase was primarily attributable to the purchase of CMBS and investment grade REIT debt.

The Company's collateralized debt obligation ("CDO") offerings allow the Company to match fund its commercial real estate portfolio by issuing long-term debt to finance long-term assets. The CDO debt is non-recourse to the Company; therefore, the Company's losses are limited to its equity investment in the CDO. The CDO debt is also fully hedged to protect the Company from an increase in short-term interest rates. The Company considers all of its CMBS rated BB+ down to B to be financeable in a CDO transaction; as of September 30, 2004, over 91% of the market value of these assets are match funded in the Company's CDOs in this manner.

Collateral as of September 30, 2004		Debt as of September 30, 2004	
Adjusted Purchase Price	Loss Adjusted Yield	Adjusted Issue Price	Weighted Average Cost of Funds *

CDO I	$446,088	8.90%	$405,185	7.21%
CDO II**	327,859	7.82	293,255	5.79
CDO III***	379,367	7.06	369,716	5.03
Total	$1,153,314	7.99%	$1,068,156	6.07%

* Weighted Average Cost of Funds is the current cost of funds plus hedging expenses.
** The Company chose not to sell $10,000 of par of CDO II debt rated BB. CDO II debt rated BBB- with a par of $12,850 was sold in August 2004.
*** The Company chose not to sell $13,069 of par of CDO III debt rated BB.

The following table details the par, fair market value, adjusted purchase price, and loss adjusted yield of the Company's commercial real estate securities outside of the CDOs as of September 30, 2004:

	Par	Fair Market Value	Dollar Price	Adjusted Purchase Price	Dollar P
Investment grade CMBS	$115,497	$116,811	101.14	$120,677	104
Investment grade REIT debt	24,000	23,005	95.85	23,972	99
CMBS rated BB+ to B	92,180	63,748	69.16	72,423	78
CMBS rated B- or lower	352,600	102,500	29.07	126,254	35
CMBS IOs	3,413,412	116,605	3.42	113,390	3
Project loans	23,293	23,915	102.67	24,281	104
Total	$4,020,982	$446,584	11.11	$480,997	11

The following table details the par, fair market value, adjusted purchase price and loss adjusted yield of the Company's commercial real estate securities outside of the CDOs as of December 31, 2003:

	Par	Fair Market Value	Dollar Price	Adjusted Purchase Price	Dollar P
Investment grade CMBS	$277,276	$268,593	96.87	$272,853	98
Investment grade REIT debt	29,000	29,567	101.95	30,210	104
CMBS rated BB+ to B	186,217	133,868	71.89	150,775	80
CMBS rated B- or lower	304,358	80,680	26.51	107,653	35
CMBS IOs	2,623,456	84,493	3.22	83,704	3
Other CMBS	20,266	20,142	99.39	20,264	99
Total	$3,440,573	$617,343	17.94	$665,459	19

BELOW INVESTMENT GRADE CMBS AND UNDERLYING LOAN PERFORMANCE

During the nine months ended September 30, 2004, the Company acquired $25,386 of par of other below investment grade CMBS and $204,957 of par of new Controlling Class securities. The total par of the Company's other below investment grade CMBS at September 30, 2004 was $329,964; the average credit protection, or subordination level, of this portfolio is 5.81%. The total par of the Company's subordinated Controlling Class CMBS securities at September

30, 2004 was $910,529 and the total par of the loans underlying these securities was $15,465,282.

The Company's investment in its Controlling Class CMBS securities by credit rating category at September 30, 2004 is as follows:

	Par	Fair Market Value	Dollar Price	Adjusted Purchase Price	Dollar Price	Subordinat
BB+	$103,772	$95,591	92.12	$88,700	85.47	6.2
BB	94,523	86,430	91.44	78,355	82.90	4.9
BB-	113,361	88,747	78.29	87,315	77.02	4.1
B+	53,478	33,139	61.97	34,978	65.41	2.9
B	194,240	114,991	59.20	141,375	72.78	2.6
B-	95,416	38,589	40.44	56,845	59.58	1.8
CCC+	11,924	5,764	48.34	7,243	60.75	1.6
CCC	70,273	15,504	22.06	22,680	32.27	0.9
CC	8,940	2,576	28.81	2,602	29.10	0.6
NR	163,002	35,749	21.93	32,918	20.19	n/
CDO investments	1,600	3,920	2.45	3,597	2.25	n/
Total	$910,529	$521,000	57.21	$556,608	61.13	

The Company's investment in its Controlling Class CMBS securities by credit rating category at December 31, 2003 is as follows:

	Par	Fair Market Value	Dollar Price	Adjusted Purchase Price	Dollar Price	Subordinat
BB+	$84,503	$73,766	87.29	$72,680	86.01	7.5
BB	89,945	75,349	83.77	76,842	85.43	6.0
BB-	101,393	71,285	70.31	81,036	79.92	5.1
B+	44,314	28,904	65.22	31,179	70.36	3.4
B	182,119	105,061	57.69	133,718	73.42	3.0
B-	83,296	34,160	41.01	51,935	62.35	1.5
CCC+	11,924	5,595	46.92	7,129	59.78	1.5
CCC	70,273	13,375	19.03	22,844	32.51	1.2
C	8,940	2,531	28.31	2,734	30.58	0.6
NR	128,325	20,939	16.32	19,254	15.00	n/
CDO investments	1,600	4,064	2.54	3,757	2.35	n/
Total	$806,632	$435,029	53.93	$503,108	62.37	

During the nine months ended September 30, 2004, one of the Company's Controlling Class securities was upgraded from BB+ to BBB and is no longer included in the chart above.

For the nine months ended September 30, 2004, the par amount of the Company's Controlling Class CMBS securities was reduced by the servicers in the amount of $30,485. Further delinquencies and losses may cause par reductions to continue and cause the Company to conclude that a change in loss-adjusted yield is required along with a write down of the adjusted purchase price through the consolidated statement of operations according to Emerging Issue Task Force

standard 99-20, "Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets." Additionally, for the nine months ended September 30, 2004, $193,528 of the underlying loan pools was repaid. Pay down proceeds are distributed to the highest rated CMBS class first and reduce the percent of total underlying collateral represented by each rating category.

For all of the Company's Controlling Class securities, the Company assumes that a total of 2.09% of the original loan balance will not be recoverable. This estimate was developed based on an analysis of individual loan characteristics and prevailing market conditions at the time of origination. This loss estimate equates to cumulative expected defaults of approximately 5.2% over the life of the portfolio and an average assumed loss severity of 40.0% of the defaulted loan balance. All estimated workout expenses including special servicer fees are included in these assumptions. Actual results could differ materially from these estimated results. See Item 3 -"Quantitative and Qualitative Disclosures About Market Risk" for a discussion of how differences between estimated and actual losses could affect Company earnings.

The Company monitors credit performance on a monthly basis and debt service coverage ratios on a quarterly basis. Using these and other statistics, the Company maintains watch lists for loans that are delinquent thirty days or more and for loans that are not delinquent but have issues that the Company's management believes require close monitoring. As part of its ongoing credit monitoring the Company periodically performs a re-underwriting of a substantial number of the underlying loans supporting its Controlling Class CMBS. The Company is currently focusing on 1998 vintage transactions and expects to be completed with this vintage by the fourth quarter of 2004. As each transaction review is completed the Company may determine that its yields in accordance with generally accepted accounting principles in the United States of America ("GAAP") and book values need to be adjusted.

The Company considers delinquency information from the Lehman Brothers Conduit Guide to be the most relevant benchmark to measure credit performance and market conditions applicable to its Controlling Class CMBS holdings. The year of issuance, or vintage year, is important, as older loan pools will tend to have more delinquencies than newly underwritten loans. The Company owns Controlling Class CMBS issued in 1998, 1999, 2001, 2003 and 2004. Comparable delinquency statistics referenced by vintage year as a percentage of current par as of September 30, 2004 are shown in the table below:

Vintage Year	Underlying Collateral	Delinquencies Outstanding	Lehman Brothers Conduit Guide
1998	$7,087,311	2.59%	2.28%
1999	700,648	1.58	2.55
2001	915,013	1.02	1.32
2003	2,160,033	0.00	0.12
2004	5,833,846	0.06	0.05
Total	$16,696,851	1.24%*	1.18%*

* Weighted average based on the Company's current principal balance.

Morgan Stanley also tracks CMBS loan delinquencies for the specific CMBS transactions with more than $200,000 of collateral and that have been seasoned for at least one year. This seasoning criterion will generally adjust for the lower delinquencies that occur in newly originated collateral. As of September 30, 2004, the Morgan Stanley index indicated that delinquencies on 273 securitizations were 1.89%, and as of December 31, 2003, this same index indicated that delinquencies on 243 securitizations were 2.47%. See Item 3 - "Quantitative and Qualitative Disclosures About Market Risks" for a detailed

discussion of how delinquencies and loan losses affect the Company.

Delinquencies on the Company's CMBS collateral as a percent of principal increased in line with expectations. The Company's aggregate delinquency experience is consistent with comparable data provided in the Lehman Brothers Conduit Guide.

Of the 35 delinquent loans shown on the chart in Note 3 of the consolidated financial statements, 1 loan was real estate owned and being marketed for sale, zero loans were being foreclosed, and the remaining 34 loans were in some form of workout negotiations. For the Company's Controlling Class securities where the Company has experienced losses, aggregate losses of $5,797 were realized during the nine months ended September 30, 2004, bringing cumulative net losses realized to $52,028 or 13% of total estimated losses for these securities. These losses include special servicer and other workout expenses. Experience to date is in line with the Company's loss expectations. Realized losses and special servicer expenses are expected to increase on the underlying loans as the portfolio ages.

The Company manages its credit risk through disciplined underwriting, diversification, active monitoring of loan performance and exercise of its right to control the workout process for delinquent loans as early as possible. The Company maintains diversification of credit exposures through its underwriting process and can shift its focus in future investments by adjusting the mix of loans in subsequent acquisitions. The comparative profiles of the loans underlying the Company's CMBS by property type as of September 30, 2004 and December 31, 2003 are as follows:

	9/30/04 Exposure		12/31/03 Exposure	
Property Type	Loan Balance	% of Total	Loan Balance	% of Total
Multifamily	$4,996,591	29.9%	$3,770,944	33.2%
Retail	5,149,425	30.8	3,446,371	30.4
Office	4,047,431	24.2	2,266,160	20.0
Lodging	901,778	5.4	786,920	6.9
Industrial	1,165,683	7.0	713,942	6.3
Healthcare	328,730	2.0	337,333	3.0
Parking	107,213	0.7	25,611	0.2
Total	$16,696,851	100%	$11,347,281	100%

As of September 30, 2004, the fair market value of the Company's holdings of Controlling Class CMBS securities is $35,609 lower than the adjusted cost for these securities. The adjusted purchase price and market value of the Company's Controlling Class CMBS portfolio as of September 30, 2004 represent approximately 61.1% and 57.2%, respectively, 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. As of September 30, 2004, the Company believes there has been no material deterioration in the credit quality of its portfolio below current expectations.

As the portfolio matures and expected losses occur, subordination levels of the lower rated classes of a CMBS investment will be reduced. This may cause the lower rated classes to be downgraded which would negatively affect their market

value and therefore the Company's net asset value. Reduced market value will negatively affect the Company's ability to finance any such securities that are not financed through a CDO or similar matched funding vehicle. In some cases, securities held by the Company may be upgraded to reflect seasoning of the underlying collateral and thus would increase the market value of the securities. For the nine months ended September 30, 2004, the Company experienced seven credit upgrades on five CMBS transactions in the Company's portfolio.

The Company's income for its CMBS securities is computed based upon a yield in accordance with GAAP, which assumes credit losses will occur. The yield to compute the Company's taxable income does not assume there will be credit losses, as a loss can only be deducted for tax purposes when it has occurred. As a result, for the period beginning with the year ended December 31, 1998 through the nine months ended September 30, 2004, the Company's GAAP income accrued on its CMBS assets was approximately $33,505 lower than the taxable income accrued on its CMBS assets.

COMMERCIAL REAL ESTATE LOAN ACTIVITY

The Company's commercial real estate loan portfolio generally emphasizes larger transactions located in metropolitan markets, as compared to the typical loan in the CMBS portfolio. The Company has never suffered a loss in this portfolio. Because the loan portfolio is relatively small and heterogeneous, the Company has determined it is not necessary to establish a loan loss reserve.

The following table summarizes the Company's commercial real estate loan portfolio by property type as of September 30, 2004 and December 31, 2003:

	Loan Outstanding				Weighted Average Co	
	September 30, 2004		December 31, 2003		September 30, 2004	Decembe
Property Type	Amount	%	Amount	%		
Office	116,165	54.7%	$57,381	76.4%	8.8%	
Residential	26,202	12.3	2,794	3.7	12.7	
Retail	193	0.1	-	-	13.5	
Hotel	69,737	32.9	14,951	19.9	6.8	
Total	$212,297	100.0%	$75,126	100.0%	8.6%	

RECENT EVENTS

On October 21, 2004, the Company priced a CDO secured by a portfolio of below investment grade CMBS ("Collateral"). The transaction will be accounted for as a sale in accordance with SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." The Company will receive total consideration of $158,032 consisting of net cash of $121,479 and CDO securities with a fair market value of $36,553 in exchange for the Collateral. The Collateral was carried at a fair market value of $109,933 on the Company's September 30, 2004 consolidated statement of financial condition based on price quotes received from third parties. The Company expects to recognize a gain of approximately $16,636 when the transaction closes in November 2004. The difference between total consideration received and the carrying value of the Collateral will increase book value by $48,099, or $0.90 per diluted common share in the fourth quarter of 2004. The following table

illustrates the pro forma impact of this transaction on September 30, 2004 reported book value per share:

Book value at September 30, 2004	$7.72	$411,101
Realized and unrealized gains	0.31	16,636
Increase in other comprehensive income	0.59	31,463
Net increase in book value	0.90	48,099
Pro Forma book value at September 30, 2004*	$8.62	$459,200

*Assumes no other changes occur in the market or the Company's portfolio.

The fair market value of the securities received in exchange for the Collateral includes the retention of 100% of the equity of the CDO. The value of the equity investment was provided by a third party and was established using a 70.5% discount rate on the cash flows computed before adjusting for credit loss assumptions. Income will be recorded from this equity investment on a loss-adjusted basis using a yield of 53.1%. The equity investment will be classified as available for sale on the Company's statement of financial condition.

The recognition of this gain increases the likelihood that the Company will incur incentive fee expense commencing in the fourth quarter of 2004. Incentive fees are computed using net income based on a rolling four-quarter period (see further discussion in Note 8 of the consolidated financial statements). The recognition of the gain will increase the income included in the rolling four-quarter period until the quarter ended December 31, 2005.

RECENT ACCOUNTING PRONOUNCEMENTS

In March 2004, the Emerging Issues Task Force ("EITF") reached a consensus on the "recognition" provisions of Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments" ("EITF No. 03-1"). EITF No. 03-1 requires that a loss be recognized for an impairment that is other-than-temporary. A three-step impairment model should be applied to debt securities subject to SFAS No. 115, including those debt securities subject to EITF No. 99-20, "Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets." On September 30, 2004, the FASB issued FASB Staff Position (FSP) EITF No. 03-1-1, "Effective Date of Paragraphs 10-20 of EITF Issue No. 03-1," which delayed the effective date of the recognition provisions of EITF No. 03-1 until the issuance of the final FSP EITF Issue 03-1-a, "Implementation Guidance for the Application of Paragraph 16 of EITF Issue No. 03-1." Until the final FSP is issued, management is not able to evaluate whether the adoption of the "recognition" provisions under such guidance will have a material effect on our results of operations or financial position.

II. RESULTS OF OPERATIONS

Net income for the three and nine months ended September 30, 2004 was $16,501 or $0.28 per share (basic and diluted) and $36,895 or $0.41 per share (basic and diluted), respectively. Net loss for the three and nine months ended September 30, 2003 was $(22,221) or $(0.51) per share (basic and diluted) and $(23,527) or $(0.60) per share (basic and diluted), respectively. Net income (loss) increased to $0.41 per share for the nine months ended September 30,

2004 as compared to $(0.60) per share for the nine months ended September 30, 2003. Net income (loss) available to common stockholders for the nine months ended September 30, 2004 includes a charge of $10,508 or $0.21 per share for the redemption of the Company's Series B Preferred Stock. Net income (loss) available to common stockholders for the nine months ended September 30, 2003 includes a charge of $32,426 or $0.68 per share for impairment charges on the Company's Controlling Class CMBS securities and a franchise loan backed security.

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

	For the Three Months Ended September 30,	
	2004	2003
	Interest Income	Interest Income
Commercial real estate securities	$32,408	$26,125
Commercial mortgage loan pools	13,715	-
Commercial real estate loans	2,979	1,190
RMBS	3,941	11,591
Cash and cash equivalents	165	453
Total	$53,208	$39,359

	For the Nine Months Ended September 30,	
	2004	2003
	Interest Income	Interest Income
Commercial real estate securities	$92,073	$71,729
Commercial mortgage loan pools	26,066	-
Commercial real estate loans	6,437	4,480
RMBS	15,731	45,626
Cash and cash equivalents	356	838
Total	$140,663	$122,673

The following chart reconciles interest income and total income for the three and nine months ended September 30, 2004 and 2003.

	For the Three Months Ended September 30,	
	2004	2003
Interest income	$53,208	$39,359
Earnings from real estate joint ventures	165	221

Earnings from equity investment	1,979	749
Other income	742	-
Total Income	$56,094	$40,329

	For the Nine Months Ended September 30,	
	2004	2003
Interest income	$140,663	$122,673
Earnings from real estate joint ventures	929	695
Earnings from equity investment	4,970	2,194
Other income	742	-
Total Income	$147,304	$125,562

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,	
	2004	200
	Interest Expense	Inter Expe
Reverse repurchase agreements	$3,130	$ 4,
Lines of credit and term loan	972	
CDO liabilities	16,162	6,
Commercial mortgage loan pools	12,646	
Total	$32,910	$ 11,

	For the Nine Months Ended September 30,	
	2004	200
	Interest Expense	Inter Expe
Reverse repurchase agreements	$8,644	$ 15
Lines of credit and term loan	2,404	
CDO liabilities	43,007	20
Commercial mortgage loan pools	24,593	
Total	$78,648	$36

The foregoing interest expense amounts for the three and nine months ended September 30, 2004, respectively, do not include $624 and $1,130 of interest expense related to hedge ineffectiveness, as well as $3,825 and $11,604 of interest expense related to swaps. The foregoing interest expense amounts for

the three and nine months ended September 30, 2003, respectively, do not include $(66) and $175 of interest expense related to hedge ineffectiveness and $9,994 and $26,135 of interest expense related to swaps and $4 and $21 of interest expense related to real estate joint ventures. The reduction in interest expense related to swaps is primarily attributable to the issuance of the Company's third CDO as well as a reduction in swap notional. See Note 11 of the consolidated financial statements, Derivative Instruments, for a 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 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. The following interest income and interest expense amounts exclude income and expense related to real estate joint ventures, equity investment, hedge ineffectiveness, and the effect of the consolidation of the commercial mortgage loan pools. The increase in net interest margin is primarily due to investing in additional higher margin commercial real estate assets.

	For the Three Months Ended September 30,	
	2004	2003
Interest income	$41,306	$39,359
Interest expense	$24,089	$21,676
Net interest margin	3.06%	2.87%
Net interest spread	2.30%	2.53%

OTHER EXPENSES: Expenses other than interest expense consist primarily of management fees and general and administrative expenses. Management fees paid to the Manager of $2,212 and $6,505 for the three and nine months ended September 30, 2004, respectively, were solely base management fees. Management fees for the nine months ended September 30, 2004 were lower than the nine months ended September 30, 2003 as the Manager agreed to reduce the management fees by 20% for the quarter ended March 31, 2004. Management fees paid to the Manager of $2,115 and $7,341 for the three and nine months ended September 30, 2003, respectively, and were solely base management fees. General and administrative expense of $886 and $2,120 for the three and nine months ended September 30, 2004, respectively, and $551 and $1,724 for the three and nine months ended September 30, 2003, respectively, were comprised of accounting agent fees, custodial agent fees, directors' fees, fees for professional services, and insurance premiums.

OTHER GAINS (LOSSES): During the nine months ended September 30, 2004 and 2003, the Company sold a portion of its securities available-for-sale for

total proceeds of $318,273 and $1,394,664, respectively, resulting in a realized gain (loss) of $857 and $(1,269) for the nine months ended September 30, 2004 and 2003, respectively. The losses on securities held for trading were $(1,103) and $(28,154) for the three months ended September 30, 2004 and 2003, respectively, and $(11,133) and $(43,273) for the nine months ended September 30, 2004 and 2003, respectively. The foreign currency loss of $(114) and $(126) for the three and nine months ended September 30, 2004, respectively, relate to the Company's net investment in commercial mortgage loans denominated in currencies other than the U.S. dollar and their associated hedging.

DIVIDENDS DECLARED: On March 11, 2004, the Company declared distributions to its stockholders of $0.28 per share, which was paid on April 30, 2004 to stockholders of record on March 31, 2004.

On May 25, 2004, the Company declared dividends to its common stockholders of $0.28 per share, paid on August 2, 2004 to stockholders of record on June 15, 2004.

On September 15, 2004, the Company declared dividends to its common stockholders of $0.28 per share paid on November 1, 2004 to stockholders of record on September 30, 2004.

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, 2004 and December 31, 2003:

Security Description	September 30, 2004 Estimated Fair Value	Percentage	Decemb 2003 Est Fai Val
Commercial mortgage-backed securities:			
CMBS IOs	$ 116,605	6.6%	
Investment grade CMBS	362,355	20.4	
Non-investment grade rated subordinated securities	792,518	44.7	
Non-rated subordinated securities	40,015	2.3	
Credit tenant lease	25,418	1.4	
Investment grade REIT debt	265,309	15.0	
Project loans	23,915	1.3	
Total CMBS	1,626,135	91.7	1,
Single-family residential mortgage-backed securities:			
Agency adjustable rate securities	119,108	6.7	
Agency fixed-rate securities	-	-	
Residential CMOs	1,654	0.1	
Hybrid arms	27,129	1.5	
Total RMBS	147,891	8.3	
Total securities available-for-sale	$ 1,774,026	100.0%	$1,

The Company's CMBS and investment grade REIT debt increased slightly from December 31, 2003 as the Company is continuing to purchase these types of assets.

Borrowings: As of September 30, 2004, the Company's debt consisted of CDOs, commercial mortgage loan pools, line-of-credit borrowings, and reverse repurchase agreements, collateralized by a pledge of most of the Company's securities available-for-sale, commercial mortgage loan pools, securities held-for-trading, and its commercial mortgage loans. As of December 31, 2003, the Company's debt consisted of CDOs, line-of-credit borrowings, and reverse repurchase agreements, collateralized by a pledge of most of the Company's securities available-for-sale, securities held-for-trading, 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, 2004 and December 31, 2003, 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, 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 would 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 Ended September 30, 2004		
	September 30, 2004 Balance	Maximum Balance	Range Maturit
Collateralized debt obligations	$1,068,156	$1,068,216	7.2 to 9.3
Commercial mortgage loan pools	1,298,985	1,298,985	3.3 to 10.0
Reverse repurchase agreements	684,307	1,148,306	1 to 5
Line of credit and term loan borrowings	134,124	391,511	280 to 58

Hedging Instruments: From time to time, the Company may reduce its exposure to market interest rates by entering into various financial instruments that adjust portfolio duration. These financial instruments are intended to mitigate the effect of changes in interest rates on the value of certain assets in the Company's portfolio. At September 30, 2004, the Company had no outstanding U.S. Treasury Note future contracts. At December 31, 2003, the Company had outstanding short positions of 30 five-year and 73 ten-year U.S. Treasury Note future contracts.

Interest rate swap agreements as of September 30, 2004 and December 31, 2003 consisted of the following:

	September 30, 2004	
		Weighted Average

	Notional Value	Estimated Fair Value	Unamortized Cost	Remaining Term
Interest rate swaps	$508,800	$(1,744)	$-	5.73 years
Interest rate swaps - CDO	945,737	(16,402)	-	8.65 years
Total	$1,454,537	$(18,146)	$-	7.62 years

	December 31, 2003			
	Notional Value	Estimated Fair Value	Unamortized Cost	Weighted Average Remaining Term
Interest rate swaps	$919,300	$(2,929)	$23	5.46 years
Interest rate swaps - CDO	626,323	(23,423)	-	9.17 years
Total	$1,545,623	$(26,352)	$23	6.96 years

As of September 30, 2004, the Company had designated $1,215,092 notional of the interest rate swap agreements as cash flow hedges. As of December 31, 2003, the Company had designated $1,066,078 notional of the interest rate swap agreements as cash flow hedges.

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, commercial mortgage loans, and proceeds from the maturity or 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 income would decline. The Company's principal strategies for mitigating this risk are to maintain portfolio leverage at levels it believes are sustainable and to diversify the sources and types of available borrowing and capital. The Company has utilized committed bank facilities and preferred stock offerings, and will consider resecuritization or other achievable term funding of existing assets.

At the end of the first quarter of 2004, the Board of Directors approved the Company's decision to redeem its Series B Preferred Stock. The second quarter of 2004 earnings includes a charge of $0.21 per share for the redemption of the Company's Series B Preferred Stock that was reported as a charge to income in the initial first quarter 2004 earnings release but was subsequently moved to the second quarter to coincide with the timing of the actual redemption payment as reported on May 11, 2004. The Series B Preferred Stock was redeemed on May 6, 2004.

For the nine months ended September 30, 2004, the Company issued 1,077,102 shares of common stock of the Company, par value $0.001 per share (the "Common

Stock"), under its Dividend Reinvestment and Stock Purchase Plan (the "Dividend Reinvestment Plan"). Net proceeds to the Company were approximately $12,606. For the nine months ended September 30, 2003, the Company issued 1,355,006 shares of Common Stock under its Dividend Reinvestment Plan. Net proceeds to the Company were approximately $15,113.

For the three and nine months ended September 30, 2004, the Company issued 253,800 shares of Common Stock under a sale agency agreement with Brinson Patrick Securities Corporation. Net proceeds to the Company were approximately $2,761.

For the three and nine months ended September 30, 2003, the Company issued 45,000 shares of Common Stock under a sale agency agreement with Brinson Patrick Securities Corporation. Net proceeds to the Company were approximately $497.

During the first quarter of 2004, the Company suspended its Dividend Reinvestment Plan for all investments after March 26, 2004, and for all future investment dates. During the second quarter of 2004, the dividend reinvestment portion of the Dividend Reinvestment Plan was reinstated for all dividend payments made after August 2, 2004, and for all future dividend payment dates with a discount of 2%. The optional cash purchase portion of the Dividend Reinvestment Plan remains suspended; however, it may be resumed at any time.

As of September 30, 2004, $90,009 of the Company's $185,000 committed credit facility with Deutsche Bank, AG was available for future borrowings and $48,767 of the Company's $75,000 committed credit facility with Greenwich Capital, Inc. was available. The Company also extended its $75,000 committed borrowing facility from Greenwich Capital, Inc. from July 2004 to July 2005. The Company borrowed $12,900 through a $13,000 committed credit facility with Morgan Stanley Mortgage Capital, Inc. The Morgan Stanley Mortgage Capital, Inc. facility matures May 11, 2006.

At September 30, 2004, the Company's collateralized borrowings had the following remaining maturities:

	Lines of Credit	Reverse Repurchase Agreements	Collateralized Debt Obligations	Comme Mortgag Poo
Within 30 days	$ -	$681,604	$ -	
31 to 59 days	-	2,703	-	
60 days to less than 1 year	134,124	-	-	
1 year to 2 years	-	-	-	
Over 5 years	-	-	1,068,156*	1,
	$134,124	$684,307	$1,068,156	$1,2

* Comprised of $405,185 of CDO debt with a weighted average remaining maturity of 7.54 years a September 30, 2004, $293,255 of CDO debt with a weighted average remaining maturity of 7.98 September 30, 2004 and $369,716 of CDO debt with a weighted average remaining maturity of 8. of September 30, 2004.

** The commercial mortgage loan pools have a weighted average remaining maturity of 7.33 years September 30, 2004.

The Company has no off-balance sheet financing arrangements.

On March 30, 2004 the Company issued its third collateralized debt obligation ("CDO III") through Anthracite CDO 2004-1. The total par value of bonds sold was $372,456. The total cost of funds on a fully hedged basis was 5.0%. CDO III also includes a $50,000 ramp facility that will be used to finance future commercial real estate assets, thus eliminating financing risk for up to $50,000 of below investment grade CMBS investments to be acquired during the year.

On June 30, 2004, the Company completed a follow-on offering of 2,100,000 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 $23,184. The Company had granted the underwriters an option, exercisable for 30 days, to purchase up to 315,000 additional shares of Common Stock to cover over-allotments. This option was exercised on July 6, 2004 and resulted in net proceeds to the Company of approximately $3,478.

In July 2004, the Company issued a bond with a par of $12,850 from its CDO II. Before issuing this security, the Company amended the indenture to reduce the coupon from 9.0% to 7.6%. As a result of this issuance, the total cost of funds on a fully hedged basis for CDO II rose from 5.7% to 5.8%.

The Company's operating activities provided cash flows of $98,330 and $461,636 during the nine months ended September 30, 2004 and 2003, respectively, primarily through sale of trading securities and net income in 2004 and through the sale of trading securities in 2003 related to the Company's reduction of its RMBS portfolio.

The Company's investing activities used cash flows of $(111,980) and $(106,132) during the nine months ended September 30, 2004 and 2003, respectively, primarily to purchase securities available-for-sale and to fund commercial mortgage loans, offset by significant sales of securities.

The Company's financing activities provided (used) cash flows of $8,108 and $(340,625) during the nine months ended September 30, 2004 and 2003, respectively, primarily from an increase in borrowings, and issuance of Common Stock, offset by dividends paid and redemption of preferred stock in 2004 and decrease in borrowings and dividends paid in 2003.

The Company is subject to various covenants in its lines of credit, including maintaining a minimum GAAP net worth of $305,000, a debt-to-equity ratio not to exceed 5.5 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. Due to the acquisition of the commercial mortgage loan pools (see Note 4 of the consolidated financial statements), the Company's debt to equity ratio increased from 4.0:1 at December 31, 2003 to 6.8:1 at September 30, 2004 and the debt service coverage ratio remained unchanged from 1.7 at December 31, 2003 to 1.5 at September 30, 2004. The Company received authorization from its lenders to permit debt to equity ratios in excess of existing covenants and is in the process of documenting permanent changes to its financial covenants. As of September 30, 2004, the Company was in compliance with all other covenants. The permanent changes to the financial covenants will likely require the Company to limit recourse debt to equity to 3.0:1 and require a minimum recourse debt service coverage ratio of 2.0. As of September 30, 2004, the Company's recourse debt to equity ratio and recourse debt service coverage ratio were 1.8:1 and 2.1, respectively.

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. Consequently, 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.

CONTINGENT LIABILITY

During 2000, the Company completed the acquisition of CORE Cap, Inc. At the time of the CORE Cap, Inc. acquisition, the Manager agreed to pay GMAC (CORE Cap, Inc.'s external advisor) $12,500 over a ten-year period ("Installment Payment") to purchase the right to manage the CORE Cap, Inc. assets under the existing management contract ("GMAC Contract"). The GMAC Contract had to be terminated in order to allow the Company to complete the merger, as the Company's management agreement with the Manager did not provide for multiple managers. As a result the Manager offered to buy-out the GMAC Contract as the Manager estimated it would receive incremental fees above and beyond the Installment Payment, and thus was willing to pay for, and separately negotiate, the termination of the GMAC Contract. Accordingly, the value of the Installment Payment was not considered in the Company's allocation of its purchase price to the net assets acquired in the acquisition of CORE Cap, Inc. The Company agreed that should the Management Agreement with its Manager be terminated, not renewed or not extended for any reason other than for cause, the Company would pay to the Manager an amount equal to the Installment Payment less the sum of all payments made by the Manager to GMAC. As of September 30, 2004, the Installment Payment would be $6,500 payable over six years. The Company does not accrue for this contingent liability.

TRANSACTIONS WITH AFFILIATES

The Company is managed pursuant to a management agreement, dated March 27, 1998, between the Company and the Manager (the "Management Agreement"), a majority owned indirect subsidiary of The PNC Financial Services Group, Inc. and the employer of certain directors and all of the officers of the Company, under which the Manager is responsible for the day-to-day operations of the Company and performs such services and activities relating to the assets and operations of the Company as may be appropriate. On March 25, 2002, the Management Agreement was extended for one year through March 27, 2003, with the approval of the unaffiliated directors, on terms similar to the prior agreement with the following changes: (i) the incentive fee calculation would be based on GAAP earnings instead of funds from operations, (ii) the removal of the four-year period to value the Management Agreement in the event of termination and (iii) subsequent renewal periods of the Management Agreement would be for one year instead of two years. The Board of Directors of the Company was advised by Houlihan Lokey Howard & Zukin Financial Advisors, Inc., a national investment banking and financial advisory firm, in the renewal process.

On March 6, 2003, the unaffiliated directors approved an extension of the Management Agreement from its expiration of March 27, 2003 for one year through March 31, 2004. The terms of the renewed agreement were similar to the prior agreement except for the incentive fee calculation which would provide for a rolling four-quarter high watermark rather than a quarterly calculation. In determining the rolling four-quarter high watermark, the Company would calculate the incentive fee based upon the current and prior three quarters' net income. The Manager would be paid an incentive fee in the current quarter if the Yearly Incentive Fee, as defined, is greater than what was paid to the Manager in the prior three quarters cumulatively. The Company phased in the rolling four-quarter high watermark commencing with the second quarter of 2003. Calculation of the incentive fee was based on GAAP and adjusted to exclude special one-time events pursuant to changes in GAAP accounting pronouncements after discussion between the Manager and the unaffiliated directors. The

incentive fee threshold did not change. The high watermark provides for the Manager to be paid 25% of the amount of earnings (calculated in accordance with GAAP) per share that exceeds the product of the adjusted issue price of the Company's common stock per share and the greater of 9.5% or 350 basis points over the ten-year Treasury note.

The Management Agreement was further extended for one year from March 31, 2004 through March 31, 2005. The base management fee was revised to equal 2% of the quarterly average total stockholders' equity for the applicable quarter. The incentive fee was revised to be 25% of the amount of earnings (calculated in accordance with GAAP) per share that exceeds the product of the adjusted issue price of the Company's common stock per share ($11.37 as of September 30, 2004) and the greater of 8.5% or 400 basis points over the ten-year Treasury note.

During the year ended December 31, 2003 and for the three months ended March 31, 2004, the Company paid 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 was 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+. During the third quarter of 2003, the Manager agreed to reduce the management fees by 20% from its calculated amount for the third and fourth quarter of 2003 and the first quarter of 2004. This revision resulted in $1,046 in savings to the Company during 2003 and $532 for the three months ended March 31, 2004, respectively.

The Company incurred $2,212 and $6,505 in base management fees in accordance with the terms of the Management Agreement for the three and nine months ended September 30, 2004, respectively, and $2,115 and $7,341 for the three and nine months ended September 30, 2003, respectively. In accordance with the provisions of the Management Agreement, the Company recorded reimbursements to the Manager of $54 for certain expenses incurred on behalf of the Company for the nine months ended September 30, 2004, respectively, and $11 and $29 for the three and nine months ended September 30, 2003, respectively, which are included in general and administrative expense on the accompanying consolidated statements of operations.

Pursuant to the March 25, 2002 one-year Management Agreement extension, the incentive fee was based on 25% of earnings (calculated in accordance with GAAP) of the Company. For purposes of calculating the incentive fee during 2002, the cumulative transition adjustment of $6,327 resulting from the Company's adoption of SFAS No. 142, "Goodwill and Other Intangible Assets" was excluded from earnings in its entirety and included in the calculation of future incentive fees using an amortization period of three years. The Company did not incur incentive fees for the three and nine months ended September 30, 2004 and 2003.

The Company has an administration agreement with the Manager. Under the terms of the administration agreement, the Manager provides financial reporting, audit coordination and accounting oversight services to the Company. The agreement can be cancelled upon 60-day written notice by either party. The Company pays the Manager a monthly administrative fee at an annual rate of 0.06% of the first $125,000 of average net assets, 0.04% of the next $125,000 of average net assets and 0.03% of average net assets in excess of $250,000 subject to a minimum annual fee of $120. For the three and nine months ended September 30, 2004, the Company paid administration fees of $43 and $129, respectively, and $44 and $130 for the three and nine months ended September 30, 2003, respectively, which are included in general and administrative expense on the accompanying consolidated statements of operations.

The Company entered into a $50,000 commitment to acquire shares in Carbon Capital, Inc. ("Carbon I"), a private commercial real estate income opportunity

fund managed by the Manager. The Carbon I investment period ended on July 12, 2004 and the Company's investment in Carbon I as of September 30, 2004 was $44,664. The Company does not incur any additional management or incentive fees to the Manager as a result of its investment in Carbon I. On September 30, 2004, the Company owned 19.8% of the outstanding shares in Carbon I.

On October 13, 2004, the Company entered into a commitment of up to $30,000 to acquire shares in Carbon Capital II, Inc. ("Carbon II"), a private commercial real estate income opportunity fund managed by the Manager. The Company may commit up to the lower of 20% of the total of Carbon II's capital commitments or $100,000. The Company does not incur any additional management or incentive fees to the Manager as a result of its investment in Carbon II. The Company's unaffiliated directors approved this transaction in September of 2004.

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

During 2000, the Company completed the acquisition of CORE Cap, Inc. At the time of the CORE Cap, Inc. acquisition, the Manager agreed to pay GMAC (CORE Cap, Inc.'s external advisor) $12,500 over a ten-year period ("Installment Payment") to purchase the right to manage the CORE Cap, Inc. assets under the existing management contract ("GMAC Contract"). The GMAC Contract had to be terminated in order to allow the Company to complete the merger, as the Company's management agreement with the Manager did not provide for multiple managers. As a result the Manager offered to buy-out the GMAC Contract as the Manager estimated it would receive incremental fees above and beyond the Installment Payment, and thus was willing to pay for, and separately negotiate, the termination of the GMAC Contract. Accordingly, the value of the Installment Payment was not considered in the Company's allocation of its purchase price to the net assets acquired in the acquisition of CORE Cap, Inc. The Company agreed that should the Management Agreement with its Manager be terminated, not renewed or not extended for any reason other than for cause, the Company would pay to the Manager an amount equal to the Installment Payment less the sum of all payments made by the Manager to GMAC. As of September 30, 2004, the Installment Payment would be $6,500 payable over six years. The Company does not accrue for this contingent liability.

REIT STATUS: The Company has elected to be taxed as a REIT and therefore must comply with the provisions of the Internal Revenue 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 includes 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 the dynamics of the markets for commercial mortgage securities and other loans and securities held by the Company. 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 majority of the Company's assets are fixed-rate securities valued based on a market credit spread to U.S. Treasuries. As U.S. Treasury securities are priced to a higher yield and/or the spread to U.S. Treasuries used to price the Company's assets is increased, the market value of the Company's portfolio may decline. Conversely, as U.S. Treasury securities are priced to a lower yield and/or the spread to U.S. Treasuries used to price the Company's assets is decreased, the market value of the Company's portfolio may increase. Changes in the market value of the Company's portfolio may affect the Company's net income or cash flow directly through their impact on unrealized gains or losses on securities held-for-trading or indirectly through their impact on the Company's ability to borrow. Changes in the level of the U.S. Treasury yield curve can also affect, among other things, the prepayment assumptions used to value certain of the Company's securities and the Company's ability to realize gains from the sale of such assets. In addition, changes in the general level of the London Interbank Offered Rate ("LIBOR") money market rates can affect the Company's net interest income. As of September 30, 2004, all of the Company's liabilities outside of the CDOs are floating rate based on a market spread to LIBOR. As the level of LIBOR increases or decreases, the Company's interest expense will move in the same direction.

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 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 counterparties 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 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 Company monitors and manages interest rate risk based on a method that takes into consideration the interest rate sensitivity of the Company's assets and liabilities, including its preferred stock. The Company's objective is to acquire assets and match fund the purchase so that interest rate risk associated with financing these assets is reduced or eliminated. The primary risks associated with acquiring and financing these assets are mark to market risk and short-term rate risk. Examples of these financing types include 30-day repurchase agreements and committed borrowing facilities. Certain secured financing arrangements provide for an advance rate based upon a percentage of the market value of the asset being financed. Market movements that cause asset values to decline would require a margin call or a cash payment to maintain the relationship between asset value and amount borrowed. A cash flow based CDO is an example of a secured financing vehicle that does not require a mark to market to establish or maintain a level of financing. When financed assets are subject to a mark to market margin call, the Company carefully monitors the interest rate sensitivity of those assets. The duration of the assets financed which are subject to a mark to market margin call was 0.76 years based on

reported GAAP book value as of September 30, 2004.

The Company's reported book value incorporates the market value of the Company's interest bearing assets but it does not incorporate the market value of the Company's interest bearing liabilities. The fixed-rate interest bearing liabilities and preferred stock will generally reduce the actual interest rate risk of the Company from a pure economic perspective even though changes in the value of these liabilities are not reflected in the Company's book value. The fixed-rate liabilities issued in CDO I, CDO II and CDO III reduce the Company's economic duration by approximately 5.17 years. The Series C Preferred Stock reduces the Company's economic duration by approximately 0.65 year. The Company's reported book value is not reduced by these liabilities and therefore is approximately 5.82 years longer than the economic duration. The Company's duration management strategy focuses on the economic risk and maintains economic duration within a band of 3.0 to 5.0 years. At September 30, 2004, economic duration was 3.50 years. Earnings per share is analyzed using the assumptions that interest rates, as defined by the LIBOR curve, increase or decrease and that the yield curves of the LIBOR rate shocks will be parallel to each other. Market value in this scenario is calculated using the assumption that the U.S. Treasury yield curve remains constant even though changes in both long- and short-term interest rates can occur simultaneously.

Regarding the table below, 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, 2004. Actual results could differ significantly from these estimates.

PROJECTED PERCENTAGE CHANGE IN
EARNINGS PER SHARE
GIVEN LIBOR MOVEMENTS

Change in LIBOR, +/- Basis Points	Projected Change in Earnings per Share
-100	$0.013
-50	$0.026
Base Case	
+50	$(0.013)
+100	$(0.026)
+200	$(0.052)

CREDIT RISK: The Company's portfolios of commercial real estate assets are subject to a high degree of 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 U.S. economy, and other factors beyond the control of the Company.

All loans are subject to a certain probability of default. Before acquiring a Controlling Class security, the Company will perform an analysis of the quality of all of the loans proposed. As a result of this analysis, loans with unacceptable risk profiles are either removed from the proposed pool or the Company receives a price adjustment. The Company underwrites its Controlling Class CMBS investments assuming the underlying loans will suffer a certain dollar amount of defaults and these defaults will lead to some level of realized losses. Loss adjusted yields are computed based on these assumptions and applied to each class of security supported by the cash flow on the underlying loans. The most significant variables affecting loss adjusted yields include, but are not limited to, the number of defaults, the severity of loss that occurs subsequent to a default and the timing of the actual loss. The

different rating levels of CMBS will react differently to changes in these assumptions. The lowest rated securities (B- or lower) are generally more sensitive to changes in timing of actual losses. The higher rated securities (B or higher) are more sensitive to the severity of losses.

The Company generally assumes that all of the principal of a non-rated security and a significant portion, if not all, of CCC and a portion of B- rated securities will not be recoverable over time. The loss adjusted yields of these classes reflect that assumption; therefore, the timing of when the total loss of principal occurs is the most important assumption in determining value. The interest coupon generated by a security will cease when there is a total loss of its principal regardless of whether that principal is paid. Therefore, timing is of paramount importance because the longer the principal balance remains outstanding, the more interest coupon the holder receives; which results in a larger economic return. Alternatively, if principal is lost faster than originally assumed, there is less opportunity to receive interest coupon; which results in a lower or possibly negative return. Additional losses which occur due to greater severity will not have a significant effect as all principal is already assumed to be non-recoverable.

If actual principal losses on the underlying loans exceed assumptions, the higher rated securities will be affected more significantly as a loss of principal may not have been assumed. The Company generally assumes that all principal will be recovered by classes rated B or higher. The Company manages credit risk through the underwriting process, establishing loss assumptions and careful monitoring of loan performance. 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 acceleration of the timing of an expected loss will cause a reduction in the expected yield and therefore reduce the earnings of the Company. Furthermore, the Company may be required to write down a portion of the adjusted purchase price of the affected assets through its consolidated statements of financial condition.

For purposes of illustration, a doubling of the losses in the Company's Controlling Class CMBS, without a significant acceleration of those losses, would reduce income going forward by approximately $0.35 per share of Common Stock per year and cause a significant write down at the time the loss assumption is changed. The amount of the write down depends on several factors, including which securities are most affected at the time of the write down, but is estimated to be in the range of $1.10 to $1.40 per share based on a doubling of expected losses. A significant acceleration of the timing of these losses would cause the Company's net income to decrease. The increase in these estimates from December 31, 2003 is a result of the Company's purchase of the below investment grade portion of five additional Controlling Class CMBS trusts. The Company's exposure to a write down is mitigated by the fact that most of these assets are financed on a non-recourse basis in the Company's CDOs, where a significant portion of the risk of loss is transferred to the CDO bondholders. As of September 30, 2004, securities with a total market value of $1,189,249 are collateralizing the CDO borrowings of $1,068,156; therefore, the Company's residual interest in the three CDOs is $121,093 ($2.27 per share). In accordance with GAAP, the CDO borrowings are not marked to market, even though their economic value will change in response to changes in interest rates and/or credit spreads.

Interest rate swap agreements contain an element of risk in the event that the counterparties to the agreements do not perform their obligations under the agreements. The Company minimizes its risk exposure by entering into agreements with parties rated at least A or better by Standard & Poor's Rating Services. Furthermore, the Company has interest rate swap agreements established with several different counterparties in order to reduce the risk of credit exposure

to any one counterparty. Management does not expect any counterparty to default on their obligations.

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 Company's objective 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.

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. 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.

ITEM 4. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures. The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-14(c) and 15d-14(c) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this report. Based on such evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, the Company's disclosure controls and procedures are effective in alerting them on a timely basis to material information relating to the Company (including its consolidated subsidiaries) required to be included in the Company's reports filed or submitted under the Exchange Act.

(b) Changes in Internal Controls. There has been no change in the Company's internal control over financial reporting during the quarter ended September 30, 2004 that has materially affected, or is reasonably likely to materially affect, such internal control over financial reporting.

Part II - OTHER INFORMATION

Item 1. Legal Proceedings

At September 30, 2004 there were no pending legal proceedings of which the Company was a defendant or of which any of its property was subject.

Item 2. Changes in Securities, Use of Proceeds and Issuer Purchases of Equity Securities

Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Ma th Und

January 1, 2004 through January 31, 2004	-	-	-
February 1, 2004 through February 29, 2004	-	-	-
March 1, 2004 through March 31, 2004	-	-	-
April 1, 2004 through April 30, 2004	-	-	-
May 1, 2004 through May 31, 2004	1,757,257(1)	25.00	1,757,257
June 1, 2004 through June 30, 2004	-	-	-
July 1, 2004 through July 31, 2004	-	-	-
August 1, 2004 through August 31, 2004	-	-	-
September 1, 2004 through September 30, 2004	-	-	-
Total	1,757,257	25.00	1,757,257

(1) At the end of the first quarter of 2004, the Board of Directors approved the Company's decision to redeem its Series B Preferred Stock. The second quarter of 2004 earnings includes a charge of $0.21 per share for the redemption of the Company's Series B Preferred Stock that was reported as a charge to income in the initial first quarter 2004 earnings release but was subsequently moved to the second quarter to coincide with the timing of the actual redemption payment as reported on May 11, 2004. The Series B Preferred Stock was redeemed on May 6, 2004.

Item 3. Defaults Upon Senior Securities

Not applicable.

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

Not Applicable.

Item 5. Other Information

Not Applicable.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

31.1 Section 302 Certification of Chief Executive Officer.

31.2 Section 302 Certification of Chief Financial Officer.

32.1 Section 906 Certification of Chief Executive Officer and Chief Financial Officer.

(b) Reports on Form 8-K

On October 25, 2004, the Company filed a Current Report on Form 8-K to report under Item 8.01 the pricing of a new collateralized debt obligation.

On November 3, 2004, the Company filed a Current Report on Form 8-K to report under Item 8.01 the Company's earnings for the quarter ended September 30, 2004.

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 9, 2004

By: /s/ Christopher A. Milner

Name: Christopher A. Milner
Title: President and Chief Executive Officer
(duly authorized representative)

Dated: November 9, 2004

By: /s/ Richard M. Shea

Name: Richard M. Shea
Title: Chief Operating Officer and Chief Financial Officer