

NEW CENTURY FINANCIAL CORP

Form 10-K

March 16, 2006

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

**Form 10-K**

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

**For the fiscal year ended December 31, 2005**

**OR**

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

**For the transition period from to**

**Commission file number 001-32314**

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

**Maryland**  
*(State or other jurisdiction  
incorporation or organization)*

**56-2451736**  
*(I. R. S. Employer  
Identification Number)*

**18400 Von Karman, Suite 1000, Irvine, California**  
*(Address of principal executive offices)*

**92612**  
*(Zip Code)*

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

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

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

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

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

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

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

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

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

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

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**PART I**

**Item 1. Business**

**General**

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

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

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

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

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

**Business Strategy**

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

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

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our mortgage loan portfolio by providing us with a significant volume of loans at a lower cost and with greater reliability than if we purchased our mortgage loan portfolio from a third party.

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

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

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

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

### **Competitive Advantages**

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

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

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

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

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



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

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

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

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

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

## **Investment and Operational Policies**

### ***Portfolio Strategy***

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

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

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





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

***Hedging policy***

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

***Financing Policy***

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

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

**Our Mortgage Loan Origination Franchise**

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

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

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

***Our Wholesale Division***

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

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

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

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

Mortgage brokers can submit loan applications through an account executive or through FastQual, our Web-based loan underwriting engine, at [www.newcentury.com](http://www.newcentury.com).

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

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

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

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

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

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

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

***Our Retail Division***

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

In connection with our acquisition of the mortgage loan origination platform from RBC Mortgage, we launched a builder/realtor channel as part of our Retail Division and expanded our product offerings to include conventional mortgage loans, loans insured by the FHA and loans guaranteed by the VA. Through the loan origination platform,

prime credit quality first-lien mortgage loans, both conforming and nonconforming, are secured by one-to-four family residences. Conforming conventional loans qualify for inclusion in guaranteed mortgage securities backed by Fannie Mae or Freddie Mac. Nonconforming conventional loans

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

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

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

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

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

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

**Wholesale Marketing**

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

**Retail Marketing**

Our retail consumer-direct channel solicits prospective borrowers through a variety of direct response advertising methods, such as purchased leads from aggregators, radio advertising, direct mail, search engine placement, banner ads, e-mail campaigns and links to related Web sites. The channel relies primarily on Internet lead acquisition, targeted direct mail, outbound telemarketing, television, radio and Internet advertisements to attract borrowers. Our

television and radio advertisements are handled by an outside advertising agency that creates our advertisements and buys our television and radio time. Our direct mail and lead acquisition programs are managed by a centralized staff who create a targeted lead list for each branch

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

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

### ***Underwriting Standards***

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

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

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

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

### ***Income Documentation***

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

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

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

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

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

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

**Credit History**

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

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

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

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



**Table of Contents*****Geographic Distribution***

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

**For the Years Ended December 31,**

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

***Financing Loan Originations***

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

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

**Loan Sales and Securitizations**

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

***Whole Loan Sales***

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

***Securitizations***

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



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