UNITED STATES

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, 2008 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: 1-14100

IMPAC MORTGAGE HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

Maryland	**33-0675505**

(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

19500 Jamboree Road, Irvine, California 92612

(Address of principal executive offices)

(949) 475-3600

(Registrant s telephone number, including area code)

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 o No x

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.

Large accelerated filer o Accelerated filer x Non-accelerated filer o Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2) Yes o No x

There were 76,100,524 shares of common stock outstanding as of November 12, 2008.

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IMPAC MORTGAGE HOLDINGS, INC.

FORM 10-Q QUARTERLY REPORT

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PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

IMPAC MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

	September 30, 2008 (Unaudited)	December 31, 2007
ASSETS		
Cash and cash equivalents	$ 24,536	$ 24,387
Trust assets		
Investment securities available-for-sale	4,856	15,248
Securitized mortgage collateral (at fair value at September 30, 2008)	8,264,413	16,532,633
Derivative assets	251	7,497
Real estate owned (REO) at net realizeable value	663,320	400,863
Total trust assets	8,932,840	16,956,241
Assets of discontinued operations	158,468	353,250
Other assets	49,617	57,194
Total assets	$ 9,165,461	$ 17,391,072
LIABILITIES		
Trust liabilities		
Securitized mortgage borrowings (at fair value at September 30, 2008)	$ 8,787,013	$ 17,780,060
Derivative liabilities	103,800	127,757
Total trust liabilities	8,890,813	17,907,817
Trust preferred securities (at fair value at September 30, 2008)	35,898	98,398
Liabilities of discontinued operations	225,536	405,341
Other liabilities	7,704	57,244
Total liabilities	9,159,951	18,468,800
Commitments and contingencies		
STOCKHOLDERS EQUITY		
Series-A junior participating preferred stock, $0.01 par value; 2,500,000 shares authorized; none issued and outstanding		
Series-B 9.375% cumulative redeemable preferred stock, $0.01 par value; liquidation value $50,000; 2,000,000 shares authorized, issued and outstanding	20	20
Series-C 9.125% cumulative redeemable preferred stock, $0.01 par value; liquidation value $111,765; 5,500,000 shares authorized; 4,470,600 shares issued and outstanding	45	45

Common stock, $0.01 par value; 200,000,000 shares authorized; 76,100,524 and 76,096,392 shares issued and outstanding as of September 30, 2008 and December 31, 2007, respectively		761		761
Additional paid-in capital		1,176,068		1,173,562
Accumulated other comprehensive income				1,028
Net accumulated deficit:				
Cumulative dividends declared		(815,076)		(803,912)
Retained deficit		(356,308)		(1,449,232)
Net accumulated deficit		(1,171,384)		(2,253,144)
Total stockholders equity (deficit)		5,510		(1,077,728)
Total liabilities and stockholders equity	$	9,165,461	$	17,391,072

See accompanying notes to consolidated financial statements.

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IMPAC MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

AND COMPREHENSIVE LOSS

(in thousands, except per share data)

(Unaudited)

	For the Three Months Ended September 30, 2008	For the Three Months Ended September 30, 2007	For the Nine Months Ended September 30, 2008	For the Nine Months Ended September 30, 2007
INTEREST INCOME:				
Total interest income	$ 397,445	$ 310,006	$ 1,077,256	$ 931,196
INTEREST EXPENSE:				
Total interest expense	394,431	298,003	1,062,637	903,377
Net interest income	3,014	12,003	14,619	27,819
Provision for loan losses		789,445		979,740
Net interest income (expense) after provision for loan losses	3,014	(777,442)	14,619	(951,921)
NON-INTEREST INCOME:				
Change in fair value of derivative instruments		(106,532)		(32,860)
Change in fair value of net trust assets, excluding REO	7,778		145	
Losses from real estate owned	(15,685)	(45,941)	(24,771)	(75,161)
Change in fair value of trust preferred securities	10,494		5,473	
Real estate advisory fees	7,039		15,581	
Other	1,847	(29,770)	5,287	(26,021)
Total non-interest income (expense)	11,473	(182,243)	1,715	(134,042)
NON-INTEREST EXPENSE:				
General and administrative	4,951	4,213	13,864	14,173
Personnel expense	2,382	2,488	7,531	4,952
Total non-interest expense	7,333	6,701	21,395	19,125
Net earnings (loss) from continuing operations	7,154	(966,386)	(5,061)	(1,105,088)
Income tax expense from continuing operations	5,253	3,056	13,980	12,012
Net earnings (loss) from continuing operations	1,901	(969,442)	(19,041)	(1,117,100)
Net loss from discontinued operations, net of tax	(18,121)	(221,793)	(28,481)	(348,350)
Net loss	(16,220)	(1,191,235)	(47,522)	(1,465,450)
Cash dividends on cumulative redeemable preferred stock	(3,722)	(3,722)	(11,165)	(11,165)
Net loss available to common stockholders	$ (19,942)	$ (1,194,957)	$ (58,687)	$ (1,476,615)

See accompanying notes to consolidated financial statements.

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	For the Three Months Ended September 30, 2008		For the Three Months Ended September 30, 2007		For the Nine Months Ended September 30, 2008		For the Nine Months Ended September 30, 2007	
Net loss	$	(16,220)	$	(1,191,235)	$	(47,522)	$	(1,465,450)
Net unrealized losses on securities:								
Unrealized holding losses arising during year				(700)				(673)
Reclassification of losses included in net earnings				(243)				(1,393)
Net unrealized losses				(943)				(2,066)
Comprehensive loss	$	(16,220)	$	(1,192,178)	$	(47,522)	$	(1,467,516)
Net loss per common share - Basic:								
Loss from continuing operations	$	(0.02)	$	(12.79)	$	(0.40)	$	(14.83)
Loss from discontinued operations		(0.24)		(2.91)		(0.37)		(4.58)
Net loss per share	$	(0.26)	$	(15.70)	$	(0.77)	$	(19.41)
Net loss per common share - Diluted:								
Loss from continuing operations	$	(0.02)	$	(12.79)	$	(0.40)	$	(14.83)
Loss from discontinued operations		(0.24)		(2.91)		(0.37)		(4.58)
Net loss per share	$	(0.26)	$	(15.70)	$	(0.77)	$	(19.41)
Dividends declared per common share	$		$		$		$	0.10

See accompanying notes to consolidated financial statements.

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IMPAC MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

	For the Nine Months Ended September 30, 2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss from continuing operations	$ (19,041)	$ (1,117,100)
Provision for loan losses		979,740
Losses from real estate owned	24,771	75,161
Amortization of deferred charge, net	13,980	12,071
Amortization of debt issuance costs and mortgage servicing rights	1,363	1,174
Amortization of premiums and securitization costs		116,609
Change in fair value of derivative instruments		136,701
Change in fair value of net trust assets, excluding REO	(113,000)	
Change in fair value of trust preferred securities	(5,473)	
Accretion of interest income and expense	385,759	
Write-down of investment securities available-for-sale		11,304
Stock-based compensation	901	961
Net change in accrued interest receivable		4,658
Net cash provided by (used in) operating activities of discontinued operations	89,973	(2,869,413)
Net change in other assets and liabilities	(42,135)	46,396
Net cash provided by (used in) operating activities	**337,098**	**(2,601,738)**
CASH FLOWS FROM INVESTING ACTIVITIES:		
Principal reductions on securitized mortgage collateral	1,409,506	4,749,658
Principal reductions on mortgages held-for-investment	59	(2,061)
Purchase of premises and equipment	357	(1,362)
Proceeds from investment securities available-for-sale	2,358	2,816
Proceeds from the sale of real estate owned	351,183	161,557
Net cash provided by investing activities of discontinued operations	13,613	395,710
Net cash provided by investing activities	**1,777,076**	**5,306,318**
CASH FLOWS FROM FINANCING ACTIVITIES:		
Cash disbursements under reverse repurchase agreements		(256,459)
Cash receipts from reverse repurchase agreements		92,455
Proceeds from securitized mortgage borrowings		3,858,143
Repayment of securitized mortgage borrowings	(1,962,577)	(5,690,970)
Common stock dividends paid		(30,326)
Preferred stock dividends paid	(11,165)	(11,165)
Proceeds from sale of cumulative redeemable preferred stock		608
Net cash used in financing activities of discontinued operations	(142,345)	(792,630)
Net cash used in financing activities	**(2,116,087)**	**(2,830,344)**
Net change in cash and cash equivalents	(1,913)	(125,764)
Cash and cash equivalents at beginning of period	26,462	179,677
Cash and cash equivalents at end of period - Continuing Operations	24,536	36,086

Cash and cash equivalents at end of period - Discontinued Operations		13		17,827
Cash and cash equivalents at end of period	$	24,549	$	53,913

See accompanying notes to consolidated financial statements.

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	For the Nine Months Ended September 30, 2008			2007
SUPPLEMENTARY INFORMATION (Continuing and Discontinued Operations):				
Interest paid	$	435,861	$	962,116
Taxes paid				116
NON-CASH TRANSACTIONS (Continuing and Discontinued Operations):				
Accumulated other comprehensive loss	$		$	(2,066)
Transfer of mortgages to real estate owned		3,009		28,445
Transfer of securitized mortgage collateral to real estate owned		628,779		419,411
Transfer of loans held-for-sale to securitized mortgage collateral				3,245,500
Transfer of securitized mortgage collateral to loans held-for-sale				27,040
Transfer of net assets from discontinued operations to continuing operations		25,600		4,012

See accompanying notes to consolidated financial statements.

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IMPAC MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data or as otherwise indicated)

Note A Summary of Business and Significant Accounting Policies

1. Business Summary and Financial Statement Presentation

Business Summary

Impac Mortgage Holdings, Inc. (the Company or IMH) is a Maryland corporation incorporated in August 1995 and has the following subsidiaries: IMH Assets Corp. (IMH Assets), Impac Warehouse Lending Group, Inc. (IWLG), and Impac Funding Corporation (IFC), together with its wholly-owned subsidiaries Impac Secured Assets Corp. (ISAC), Impac Commercial Capital Corporation (ICCC).

During late 2007, the Company s board of directors elected to discontinue the non-conforming mortgage operations conducted by IFC, commercial operations conducted by ICCC, retail mortgage operations conducted by IFC, and warehouse lending operations conducted by IWLG (collectively, the discontinued operations).

The Company consists of the continuing operations, which includes the long-term mortgage portfolio (residual interests in securitizations) conducted by IMH and IMH Assets, the master servicing portfolio, and real estate advisory fees from the Company s advisory services agreement with a real estate marketing company.

The information contained throughout this document is presented on a continuing basis, unless otherwise stated.

Financial Statement Presentation

The accompanying unaudited consolidated financial statements of IMH and its subsidiaries (as defined above) have been prepared in accordance with Accounting Principles Generally Accepted in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring adjustments considered necessary for a fair presentation, have been included. Operating results for the three-month and nine-month periods ended September 30, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008.

All significant inter-company balances and transactions have been eliminated in consolidation. In addition, certain amounts in the prior periods consolidated financial statements have been reclassified to conform to the current year presentation.

Management has made a number of estimates and assumptions relating to the reporting of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period to prepare these consolidated financial statements in conformity with GAAP. The items affected by management s estimates and assumptions include the valuation of trust assets and liabilities, the valuation of repurchase liabilities related to loans sold to investors, the valuation of trust preferred securities, the valuation of lease restructuring liabilities and the valuation of loans held-for-sale. Actual results could differ from those estimates.

Market Conditions, Status of Operations, Liquidity and Capital Resources

Real estate prices have fallen significantly since the peak levels in 2006. During the third quarter of 2008, the credit and housing markets continued to suffer from significant market disruption due to continued deterioration of the real estate and credit markets. The federal government has taken steps to attempt to stabilize the housing and credit markets. At this time, the government s actions have not affected the Company s financial position or operations.

In 2007 and 2008, management has been seriously challenged by the unprecedented turmoil in the mortgage market, including the following: significant increases in delinquencies and foreclosures; significant increases in credit-related losses; decline in originations; tightening of warehouse credit and the virtual elimination of the market for loan securitizations. As a result, the Company discontinued certain operations, resolved and terminated all but one of the Company s reverse repurchase facilities and settled a portion of its outstanding repurchase claims, while also reducing its operating costs and liabilities in 2007.

During the third quarter of 2008, the Company continued to fund its operations with revenues and cash flows from real estate advisory fees and its residual interests in securitizations and master servicing fees generated from the long-term mortgage portfolio.

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In the first quarter of 2008, the Company entered into an agreement with a real estate marketing company to generate advisory fees. The real estate marketing company specializes in the marketing of foreclosed properties. During the three and nine months ended September 30, 2008, the Company earned $7.0 million and $15.6 million, respectively, from this relationship. On November 12, 2008, the Company and the real estate marketing company agreed to terminate the advisory services agreement. See Note L for details of the agreement to terminate.

In July 2008, the Company executed a letter of intent, subject to execution of definitive agreements, to acquire a special servicing platform, whereby the seller will contribute specified balances of loans (mostly distressed) to the platform in order to provide sufficient cash flows to maintain the business during its initial operations.

In September 2008, the Company entered into an agreement to restructure its reverse repurchase line with its remaining lender. See Note J for details of the restructure.

The Company paid its October 2008 trust preferred interest payment as part of its negotiations to restructure or exchange the current trust preferred securities. To date, the Company has been unsuccessful in completing these negotiations.

In July 2008, the Company s stockholders approved the potential issuance of common shares in excess of 20 percent of the existing common shares.

There can be no assurance that the Company will be successful in acquiring the special servicer, restructuring the trust preferred securities or exchanging the preferred stock. In any event, the Company intends to reduce operating expenses to a level that is supportable by the revenues from the existing long-term mortgage portfolio (residual interests in securitizations), master servicing portfolio and real estate advisory fees.

If the Company is not successful in completing the objectives outlined above, it may not be able to meet its contractual obligations for the next year, including repayment of the restructured reverse repurchase line, interest payments on trust preferred securities and preferred stock dividends.

2. Adoption of New Accounting Standards

Adoption of SFAS 157 Fair Value Measurements

The Company prospectively adopted the provisions of Financial Accounting Standards Board (FASB) Statement No. 157 Fair Value Measurements (SFAS 157), as of January 1, 2008. SFAS 157 defines fair value, expands disclosure requirements around fair value and specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company s market assumptions. These two types of inputs create the following fair value hierarchy:

- Level 1 Quoted prices for identical instruments in active markets.

- Level 2 Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets.

- Level 3 Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

This hierarchy requires the Company to use observable market data, when available, and to minimize the use of unobservable inputs when determining fair value.

For some products or in certain market conditions, observable inputs may not always be available. Through the third quarter of 2008, certain markets remained inactive, and some key observable inputs used in valuing certain financial assets and liabilities were unavailable. Under the provisions of FASB Staff Position No. 157-3 Determining the Fair Value of a Financial Asset When the

Market for That Asset Is Not Active , in situations in which there is little, if any, market activity for an asset at measurement date, the fair value measurement objective remains to measure the financial asset at the price that would be received by the holder of the financial asset in an orderly transaction that is not a forced liquidation or distressed sale at the measurement date. In the absence of observable market data at September 30, 2008, the Company s fair value measurements include its own internal assumptions about future cash flows and appropriately risk-adjusted discount rates that it believes market participants would make in orderly market transactions. When and if these markets become active, the Company will use the related observable inputs available at that time. Therefore, at September 30, 2008, all of the items measured at fair value are considered Level 3 fair value measurements.

Under fair value accounting, the Company is required to take into account its own credit risk when measuring the fair value of assets and liabilities.

Adoption of SFAS 159 - Fair Value Option

The adoption of Statement No. 159 The Fair Value Option for Financial Assets and Financial Liabilities (SFAS 159) has also resulted in new valuation techniques used by the Company when determining fair value, most notably to value its securitized mortgage collateral and borrowings and trust preferred securities, which had not previously been carried at fair value. The Company prospectively adopted SFAS 159 as of January 1, 2008. SFAS 159 provides an option on an instrument-by-instrument basis for most financial assets and liabilities to be reported at fair value with changes in fair value reported in earnings. After the initial adoption, the election is made at the acquisition of a financial asset, financial liability, or a firm commitment and it may not be revoked. Management believes that the adoption of SFAS 159 provides an opportunity to mitigate volatility in reported earnings and provides a better representation of the economics of the trust assets and liabilities.

Under the SFAS 159 transition provisions, the Company elected to apply fair value accounting to certain financial instruments (certain trust assets, trust liabilities and trust preferred securities) held at January 1, 2008. Differences between the December 31, 2007 carrying values and the January 1, 2008 fair values were recognized as an adjustment to retained deficit. The adoption of SFAS 159 resulted in a $1.1 billion decrease to retained deficit on January 1, 2008 from $(1.4) billion at December 31, 2007 to $(308.8) million at January 1, 2008.

As a result of deterioration in the real estate market since the second half of 2007, the Company significantly added to its allowance for loan losses during the third and fourth quarters of 2007. Principally, because of the increase in the allowance for loan losses, the Company reported a stockholders deficit as of December 31, 2007. This stockholders deficit was created primarily because the Company was required under GAAP to record an allowance for loan losses that reduced securitized mortgage collateral in its consolidated trusts below the balance of the related securitized mortgage borrowings, resulting in a negative investment in certain consolidated trusts, even though the related trust agreements are nonrecourse to the Company. However, with the adoption of SFAS 159, the Company s net investment position is unable to go below zero since the related trust liabilities are also recorded at fair value. Therefore the difference between the fair value of the trust assets and trust liabilities represents the net investment interests (residual interests in securitizations) in the consolidated trusts at fair value.

The following table summarizes the initial retained earnings charge related to the prospective adoption of SFAS 159 as of January 1, 2008 and the related fair value balances as of January 1, 2008.

Adoption Net

	Ending Balance as of December 31, 2007 (Prior to Adoption)	Gain/(Loss)	Fair Value Balance as of January 1, 2008 (After Adoption) (5)
Impact of electing the fair value option under SFAS 159:			
Investment securities available-for-sale	$ 15,248	$ 1,028(1)	$ 15,248
Securitized mortgage collateral (2)	16,532,633	(821,311)	15,711,322
Securitized mortgage borrowings (3)	(17,780,060)	1,903,283	(15,876,777)
Trust preferred securities	(98,398)	57,446	(40,952)
Cumulative-effect adjustment (pre-tax)		1,140,446	
Tax impact (4)			
Cumulative-effect adjustment to reduce retained deficit		**$ 1,140,446**	
Total retained deficit as of December 31, 2007		$ (1,449,232)	
Cumulative-effect adjustment to reduce retained deficit		1,140,446	
Total retained deficit as of January 1, 2008 (6)		**$ (308,786)**	

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(1) Investment securities available-for-sale are recorded at fair value at December 31, 2007, with a corresponding $1,028 thousand unrealized gain included in accumulated other comprehensive income. Included in the cumulative-effect adjustment was $1,028 thousand in unrealized holding gains that were reclassified from accumulated other comprehensive income to retained deficit. Due to the effect of reclassifying the $1,028 thousand from accumulated other comprehensive income to retained deficit, the investment securities available-for-sale balances do not add across.

(2) Components of securitized mortgage collateral at December 31, 2007 include the allowance for loan loss of $1.2 billion, accrued interest of $99.7 million and premiums of $183.1 million, which were part of its fair value for the adoption of SFAS 159. At September 30, 2008 and December 31, 2007, securitized mortgage collateral included $10.4 million and $9.1 million, respectively in master servicing rights, recorded at the lower of cost or market, related to consolidated securitizations and recorded at the lower of cost or market.

(3) Components of securitized mortgage borrowings at December 31, 2007 include accrued interest of $17.1 million and securitization costs of $37.5 million, which were part of its fair value for the adoption of SFAS 159.

(4) There was no tax effect of the adoption of SFAS 159 as the Company qualifies as a REIT for federal income tax purposes and its tax liabilities are only related to it deferred charges associated with previous inter-company loan sales.

(5) The securitized mortgage collateral and securitized mortgage borrowings include the mortgage insurance and bond insurance proceeds to be received from third parties.

(6) As of January 1, 2008, after adoption of SFAS 159, total stockholders equity was $61.7 million

Changes in Significant Accounting Policies

Investment Securities Available-for-Sale

The Company elected to continue to account for all of its existing investment securities available-for-sale at fair value. Interest income is recorded based on the effective yield for the period based on the valuation of the previous quarter. Net gains and losses resulting from changes in fair value of investment securities available-for-sale are recorded within change in fair value of net trust assets in the Company s consolidated statement of operations and comprehensive loss.

The Company s election to account for its investment securities available-for-sale at fair value was based on the Company s overall objective of moving toward fair value accounting for significant financial assets and liabilities. The election of SFAS 159 for these investment securities results in increased volatility within net earnings as a result of the recognition of fair value changes with no offsetting amounts that would result if these assets were economically hedged. However, management believes that electing fair value accounting for its investment securities results in a stronger reflection of the value, while furthering its objective of migrating toward fair value accounting.

Securitized Mortgage Collateral and Borrowings

The Company elected to account for certain of its securitized assets at fair value. Interest income on securitized mortgage collateral and interest expense on securitized mortgage borrowings, respectively, is recorded based on the effective yield for the period based on the previous quarter s valuation resulting in interest income and interest expense accretion included in interest income and interest expense in the Company s consolidated statement of operations and comprehensive loss. Net gains (losses) resulting from the changes in fair value of securitized mortgage collateral and borrowings, are included in change in fair value of net trust assets, excluding REO, within non-interest income in the Company s consolidated statement of operations and comprehensive loss. Electing the fair value option allows the Company to avoid the burden of recording losses on collateral for which the Company will not ultimately bare the loss. In addition, recording the collateral and borrowings at fair value will help to reflect the true economics of the transactions within the consolidated statement of operations and comprehensive loss. Upon the adoption of SFAS 159, all deferred costs associated with securitized mortgage collateral and borrowings have been recognized as a cumulative effect of a change in accounting principle within retained deficit as of January 1, 2008.

Trust Preferred Securities

The Company elected to account for all of its trust preferred securities at fair value. Interest expense on trust preferred securities is recorded based on the effective yield for the period and included in interest expense in the consolidated statement of operations and comprehensive loss. Gains and losses resulting from the changes in fair value of trust preferred securities are recorded within change in fair value of trust preferred securities in the Company s consolidated statement of operations and comprehensive loss.

The Company s election to account for its trust preferred securities at fair value was based on the Company s overall objective of moving toward fair value accounting for significant financial assets and liabilities. The election of SFAS 159 for these liabilities results in increased volatility within net earnings as a result of the recognition of fair value changes with no offsetting amounts that would result if these liabilities were economically hedged. However, management believes that electing fair value accounting for its trust preferred securities results in a stronger reflection of the value, while furthering its objective to migrate toward fair value accounting.

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3. Recent Accounting Pronouncements

In October 2008, the FASB issued FASB Staff Position No. 157-3 Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active (FSP 157-3). The staff position clarifies the application of SFAS 157 in inactive markets and provides an illustrative example of how the fair value of a financial asset is determined in an inactive market. FSP 157-3 is effective immediately, including prior periods for which financial statements have not been issued. The issuance of this staff position affects the Company as a significant portion of the Company s financial assets and liabilities are measured at fair value using market value approaches based on active markets. Availability of observable market inputs has diminished considerably as a result of the increasing inactivity in the secondary market for mortgage loans, mortgage-backed securities and other real estate related assets. The lack of observable market inputs requires that the Company rely heavily on its own internal assumptions of the future cash flows and appropriate risk-adjusted discount rates market participants would apply in measuring the fair value of financial assets and liabilities in orderly market transactions that are not forced liquidations or distressed sales. As discussed in Note B, a significant portion of the Company s financial assets and liabilities, which were previously classified as Level 2 fair value measurements, were classified as Level 3 fair value measurements at September 30, 2008, as a result of market inactivity and the lack of availability of observable market inputs.

In May 2008, the FASB issued SFAS No. 162, The Hierarchy of Generally Accepted Accounting Principles (SFAS 162). The new standard is intended to improve financial reporting by identifying a consistent framework for selecting accounting principles to be used in preparing financial statements that are presented in conformity with U.S. GAAP for nongovernmental entities. SFAS 162 will be effective 60 days after the U.S. Securities and Exchange Commission approves the Public Company Accounting Oversight Board s amendments to AU Section 411, The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles. The Company does not expect the adoption of SFAS 162 to have a significant impact on its consolidated financial statements.

In April 2008, the FASB voted to eliminate qualifying special purpose entities (QSPEs) from the guidance in FASB Statement No. 140 Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities (SFAS 140). While the revised standard has not been finalized and the FASB s proposals will be subject to a public comment period, this change may have a significant impact on the Company s consolidated financial statements as it may lose sales treatment for assets previously sold to a QSPE, as well as for future sales. An effective date for any proposed revisions has not been determined by the FASB. As of September 30, 2008, the current principal balance of QSPEs to which the Company, acting as principal, has transferred assets and received sales treatment were $699.0 million. The Company s investment in these QSPE s consists of residual interests accounted for as investment securities available-for-sale in its consolidated balance sheets.

In connection with the proposed changes to SFAS 140, the FASB also is proposing three key changes to the consolidation model in FASB Interpretation No. 46(R), Consolidation of Variable Interest Entities (revised December 2003) an interpretation of ARB No. 51 (FIN 46(R)). First, the FASB has proposed to include former QSPEs in the scope of FIN 46(R). In addition, the FASB supports amending FIN 46(R) to change the method of analyzing which party to a variable interest entity (VIE) should consolidate the VIE to a primarily qualitative determination of control instead of today s risks and rewards model. Finally, the proposed amendment is expected to require all VIEs and their primary beneficiaries to be reevaluated quarterly. The previous rules required reconsideration only when specified reconsideration events occurred. As of September 30, 2008, the current principal balance of significant unconsolidated VIEs with which the Company is involved were approximately $699.0 million.

The Company will be evaluating the impact of these changes on the Company s consolidated financial statements once the standard is approved and issued.

In March 2008, the FASB issued Statement No. 161, Disclosures about Derivative Instruments and Hedging Activities (SFAS 161), an amendment of FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS 133), to expand disclosure requirements for an entity s derivative and hedging activities. Under SFAS 161, entities are required to provide enhanced disclosures about how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for under SFAS 133 and its related interpretations, and how derivative instruments and related hedged items affect an entity s financial position, financial performance, and cash flows. In order to meet these requirements, entities shall include qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of and gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative agreements. SFAS 161 is effective for fiscal years and interim periods beginning after November 15, 2008 with early adoption encouraged. The Company plans to adopt SFAS 161 on January 1, 2009, and there should be no impact on the consolidated financial statements as it only addresses disclosures.

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4. Legal Proceedings

The Company is party to litigation and claims which are normal in the course of its operations. While the results of such litigation and claims cannot be predicted with certainty, the Company believes the final outcome of such matters will not have a material adverse effect on the Company s financial condition or results of operations.

The Company believes that it has meritorious defenses to the above claims and intends to defend these claims vigorously. Nevertheless, litigation is uncertain and the Company may not prevail in the lawsuits and can express no opinion as to their ultimate resolution. An adverse judgment in any of these matters could have a material adverse effect on the Company.

Please refer to IMH s report on Form 10-K for the year ended December 31, 2007 and reports on Form 10-Q for the periods ending March 31, 2008 and June 30, 2008 for a description of other litigation and claims.

5. Income Taxes and Deferred Charge

In accordance with Accounting Research Bulletin No. 51, Consolidated Financial Statements, the Company records a deferred charge representing the deferral of income tax expense on inter-company profits that resulted from the sale of mortgages from taxable subsidiaries to IMH in prior years. The deferred charge is included in other assets in the accompanying consolidated balance sheets and is amortized as a component of income tax expense in the accompanying consolidated statements of operations over the estimated life of the mortgages retained in the securitized mortgage collateral. The Company recorded a tax provision of $5.3 million and $14.0 million for the three and nine months ending September 30, 2008 and $3.1 million and $12.0 million for the three and nine months ending September 30, 2007, respectively. The net provision is the result of the amount of the deferred charge amortized and/or impaired resulting from credit losses, which does not result in any tax liability required to be paid.

Note B Fair Value of Financial Instruments

The Company s consolidated financial statements include financial assets and liabilities that are measured based on their estimated fair values. The use of fair value to measure the Company s financial instruments is fundamental to its consolidated financial statements and is a critical accounting estimate because a substantial portion of its assets and liabilities are recorded at estimated fair value.

The application of fair value estimates may be on a recurring or nonrecurring basis depending on the accounting principles applicable to the specific asset or liability or whether management has elected to carry the item at its estimated fair value as discussed previously.

Effective January 1, 2008, the Company adopted two pronouncements affecting its fair value measurements and accounting: SFAS 157 and SFAS 159.

SFAS 157 defines fair value as the price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. SFAS 157 establishes a three-tiered fair value hierarchy that prioritizes the inputs used to estimate fair value into three broad levels, considering the relative reliability of the inputs:

- Level 1 Quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities include debt and equity securities and derivative contracts that are traded in an active exchange market, as well as certain U.S. treasury, other U.S. Government and agency mortgage-backed debt securities that are highly liquid and are actively traded in over-the-counter markets.

- Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include securities with quoted prices that are traded less frequently than exchange-traded instruments, securities and derivative contracts and financial liabilities whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data. This category generally includes trust assets or liabilities where more than a significant percentage of the fair values were derived using a pricing process that was based upon observable inputs.

- Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

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This category includes those assets and liabilities that were not included in Level 1 or Level 2.

The following table presents for each of these hierarchy levels, the Company s assets and liabilities that are measured at fair value on a recurring basis, including financial instruments for which the Company has elected the fair value option at September 30, 2008.

	Recurring Fair Value Measurements At September 30, 2008		
	Level 1	**Level 2**	**Level 3**
Assets			
Investment securities available-for-sale	$	$	$ 4,856
Securitized mortgage collateral (1)			8,253,995
Total Assets at Fair Value	$	$	**$ 8,258,851**
Liabilities			
Securitized mortgage borrowings	$	$	$ 8,787,013
Derivative liabilities, net (2)			103,549
Trust preferred securities			35,898
Total Liabilities at Fair Value	$	$	**$ 8,926,460**

(1) Excluded from securitized mortgage collateral above is $10.4 million in master servicing rights related to consolidated securitizations and recorded at the lower of cost or market. Also, securitized mortgage collateral excludes REO, which is separately presented within trust assets in the consolidated balance sheet.

(2) Derivative liabilities, net includes $251 thousand in derivative assets and $103.8 million in derivative liabilities, included within trust assets and trust liabilities, respectively.

During the third quarter of 2008, market inactivity has resulted in a lack of observable market data for purposes of measuring the fair value of financial assets and liabilities. As a result of the severe market inactivity, the Office of the Chief Accountant of the Securities and Exchange Commission (SEC) and the FASB jointly issued a press release to assist financial statement users, preparers, and auditors with application issues surrounding the determination of the fair value of financial assets in markets that are inactive. Subsequent to the issuance of the joint press release, the FASB issued FSP 157-3, which formalizes the guidance jointly issued by the SEC and FASB.

As a result of the lack of observable market data resulting from inactive markets, the Company has classified its investment securities available-for-sale, securitized mortgage collateral and borrowings and net derivative liabilities as Level 3 fair value measurements at September 30, 2008. Level 3 assets and liabilities were 100 percent of total assets and liabilities at fair value.

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The following tables present a reconciliation for all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three and nine months ended September 30, 2008:

Level 3 Recurring Fair Value Measurements
Three Months Ended September 30, 2008

	Fair Value - June 30, 2008	Total Gains (Losses) Included in Earnings	Transfers to Level 3	Purchases, issuances and settlements	Fair Value - September 30, 2008	Unrealized gains (losses) still held (1)
Investment securities available-for-sale	$ 8,644	$ (2,626)	$	$ (1,162)	$ 4,856	$ (3,788)
Securitized mortgage collateral	298,189	(2,256,972)	10,747,133	(534,355)	8,253,995	(2,791,327)
Securitized mortgage borrowings	(316,968)	2,141,292	(11,180,164)	568,827	(8,787,013)	2,710,119
Derivative liabilities, net		(10,890)	(136,471)	43,812	(103,549)	32,922
Trust preferred securities	(46,266)	10,368			(35,898)	10,368

Level 3 Recurring Fair Value Measurements
Nine Months Ended September 30, 2008

	Fair Value - January 1, 2008	Total Gains (Losses) Included in Earnings	Transfers to Level 3	Purchases, issuances and settlements	Fair Value - September 30, 2008	Unrealized gains (losses) still held (1)
Investment securities available-for-sale	$ 15,248	$ (8,034)	$	$ (2,358)	$ 4,856	$ (10,392)
Securitized mortgage collateral	782,574	(5,408,626)	14,919,649	(2,039,602)	8,253,995	(7,448,228)
Securitized mortgage borrowings	(767,704)	5,125,864	(15,109,073)	1,963,900	(8,787,013)	7,089,764
Derivative liabilities, net		(94,399)	(120,260)	111,110	(103,549)	16,711
Trust preferred securities	(40,952)	5,054			(35,898)	5,054

(1) Represents the amount of total gains or losses for the period, included in earnings, attributable to the change in unrealized gains (losses) relating to assets and liabilities classified as Level 3 that are still held at September 30, 2008.

As discussed above, the significant market disruption due to continued deterioration of the real estate and credit markets and the resulting lack of observable market data from these markets during the third quarter of 2008 resulted in securitized mortgage collateral and borrowings and net derivative liabilities being classified as Level 3 fair value measurements at September 30, 2008. During the quarter, $10.7 billion and $11.2 billion in securitized mortgage collateral and borrowings, respectively, was transferred from Level 2 to Level 3 fair value measurements. For the nine months ended September 30, 2008, $14.9 billion and $15.1 billion in securitized mortgage collateral and borrowings, respectively, was transferred from Level 2 to Level 3 fair value measurements. There were no changes, for the three and nine months ended September 30, 2008, in the classification of investment securities available-for-sale or trust preferred securities, which remained Level 3 fair value measurements.

The tables below summarize gains and losses due to changes in fair value, including both realized and unrealized gains and losses, recorded in earnings for Level 3 assets and liabilities for the three and nine months ended September 30, 2008.

	Recurring Fair Value Measurements Level 3 - Total Gains (Losses) Included in Net Loss Three Months Ended September 30, 2008				
	Investment Securities Available-for-Sale	Securitized Mortgage Collateral	Securitized Mortgage Borrowings	Derivative Liabilities, Net	Trust Preferred Securities
Interest income	$ 466	$ 134,377	$	$	$
Interest expense			(271,817)		(126)
Change in fair value of net trust assets, excluding REO	(3,092)	(2,391,349)	2,413,109	(10,890)	
Change in fair value of trust preferred securities					10,494
Total	**$ (2,626)**	**$ (2,256,972)**	**$ 2,141,292**	**$ (10,890)**	**$ 10,368**

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Recurring Fair Value Measurements
Level 3 - Total Gains (Losses) Included in Net Loss
Nine Months Ended September 30, 2008

	Investment Securities Available-for-Sale	Securitized Mortgage Collateral	Securitized Mortgage Borrowings	Derivative Liabilities, Net	Trust Preferred Securities
Interest income	$ 865	$ 231,288	$	$	$
Interest expense			(617,493)		(419)
Change in fair value of net trust assets, excluding REO	(8,899)	(5,639,914)	5,743,357	(94,399)	
Change in fair value of trust preferred securities					5,473
Total	**$ (8,034)**	**$ (5,408,626)**	**$ 5,125,864**	**$ (94,399)**	**$ 5,054**

SFAS 159 permits fair value accounting to be elected for certain assets and liabilities on an individual contract basis at the time of acquisition or under certain other circumstances referred to as remeasurement event dates. For those items for which fair value accounting is elected, changes in fair value will be recognized in earnings, and fees and costs associated with the origination or acquisition of such items will be recognized as incurred rather than deferred. In addition, SFAS 159 allows application of the Statement s provisions to eligible items existing at the effective date and management has elected to apply SFAS 159 to certain of those items as discussed below.

The following is a description of the measurement techniques for items recorded at fair value on a recurring basis and a non-recurring basis.

Recurring basis

Investment Securities Available-for-Sale. Pursuant to the Company s adoption of SFAS 159, the Company elected to carry all of its investment securities available-for-sale at fair value. These investment securities are recorded at fair value and consist primarily of non-investment grade mortgage-backed securities. The fair value of the investment securities are measured based upon the Company s expectation of inputs that other market participants would use. Such assumptions include judgments about the underlying collateral, prepayment speeds, credit losses, forward interest rates and certain other factors. Given the market disruption and lack of observable market data as of September 30, 2008, the fair value of the investment securities available-for-sale were measured using significant internal expectations of market participants assumptions. At September 30, 2008, investment securities available-for-sale were classified as Level 3 fair value measurements.

Securitized Mortgage Collateral Pursuant to the Company s adoption of SFAS 159, the Company elected to carry all of its securitized mortgage collateral at fair value. These assets consist primarily of Alt-A mortgage loans securitized between 2002 and 2007. Fair value measurements are based on the Company s estimated cash flow models, which incorporate assumptions, inputs of other market participants and quoted prices for the underlying bonds. The Company s assumptions include its expectations of inputs that other market participants would use. These assumptions include judgments about the underlying collateral, prepayment speeds, credit losses, forward interest rates and certain other factors. At September 30, 2008, securitized mortgage collateral was classified as Level 3 fair value measurements based on the lack of observability of significant inputs to the model. As of September 30, 2008, the unpaid principal balance and estimated fair value of securitized mortgage collateral was $14.7 billion and $8.3 billion, respectively. The aggregate unpaid principal balance exceeds the fair value by $6.4 billion at September 30, 2008. As of September 30, 2008, the unpaid principal balance and estimated fair value of loans 90 days or more past due was $2.4 billion and $1.3 billion, respectively. The aggregate unpaid principal balances of loans 90 days or more past due exceed the fair value by $1.1 billion at September 30, 2008.

Securitized Mortgage Borrowings - Pursuant to the Company s adoption of SFAS 159, the Company elected to carry all of its securitized mortgage borrowings at fair value. These borrowings consist of individual tranches of bonds issued by securitization trusts and are primarily backed by Alt-A mortgage loans. Fair value measurements include the Company s judgments about the underlying collateral assumptions such as prepayment speeds, credit losses, forward interest rates and certain other factors and are based upon quoted prices for the individual tranches of bonds, if available. At September 30, 2008, securitized mortgage borrowings were classified as Level 3 fair value measurements based on the lack of observability of significant inputs to the model. As of September 30, 2008, the outstanding principal balance and estimated fair value of securitized mortgage borrowings was $15.8 billion and $8.8 billion, respectively. The aggregate outstanding principal balance exceeds the fair value by $7.0 billion at September 30, 2008.

Trust Preferred Securities - Pursuant to the Company s adoption of SFAS 159, the Company elected to carry all of its trust preferred securities at fair value. These securities were measured based upon an analysis prepared by the Company, which considered the Company s own credit risk, included a comparison to the terms of the Company s preferred stock and the expected terms of restructuring negotiations with a majority of the trust preferred debt holders.

At September 30, 2008 trust preferred securities were classified as Level 3 measurements based on the lack of observability of market inputs. As of September 30, 2008, the unpaid principal balance and fair value of trust preferred securities was $99.2 million and $35.9 million, respectively. The aggregate unpaid principal balance exceeds the fair value by $63.3 million at September 30, 2008.

Derivative Assets and Liabilities. For non-exchange traded contracts, fair value is based on the amounts that would be required to settle the positions with the related counterparties as of the valuation date. Valuations of derivative assets and liabilities are based on observable market inputs, if available. To the extent observable market inputs are not available, fair values measurements include the Company s judgments about the future cash flows, forward interest rates and certain other factors, including counterparty risk. With the issuance of SFAS 157, these values must also take into account the Company s own credit standing, to the extent applicable, thus included in the valuation of the derivative instrument is the value of the net credit differential between the counterparties to the derivative contract. At September 30, 2008, derivative assets and liabilities were classified as Level 3 fair value measurements based on the lack of observability of market inputs.

On September 15, 2008, Lehman Brothers Holdings Inc. (LBHI) filed a petition for protection under Chapter 11 of the U.S. Bankruptcy Code. As of that date, LBHI, through affiliated companies, was an interest rate swap counterparty to several of the Company s CMO and REMIC securitizations. As the related securitization trusts are non-recourse to the Company, the Company is not required to replace or otherwise settle any derivative positions affected by counterparty default within the consolidated trusts. At September 30, 2008, the estimated value of these derivatives is included in derivative liabilities in the consolidated balance sheet.

Non-recurring basis

The Company is required to measure certain assets at fair value from time-to-time. These fair value measurements typically result from the application of specific accounting pronouncements under GAAP. The fair value measurements are considered non-recurring fair value measurements under SFAS 157.

Loans Held-for-Sale - Loans held-for-sale for which the fair value option was not elected are carried at lower of cost or market (LOCOM). When available, such measurements are based upon what secondary markets offer for portfolios with similar characteristics, and are considered Level 2 measurements. If market pricing is not available, such measurements are significantly impacted by the Company s expectations of other market participants assumptions, and are considered Level 3 measurements. The Company utilizes internal pricing processes to estimate the fair value of loans held-for-sale, which is based on recent loan sales and estimates of the fair value of the underlying collateral. Loans held-for-sale, which are primarily included in assets of discontinued operations, are considered Level 3 fair value measurements at September 30, 2008 based on the lack of observability of market inputs.

Mortgage Servicing Rights - Mortgage servicing rights (MSRs) for which the fair value option was not elected are carried at LOCOM. MSRs are not traded in an active market with observable prices. The Company utilizes internal pricing processes to estimate the fair value of MSRs, which are based on assumptions the Company believes would be used by market participants, including market discount rates, float, prepayment speeds and master servicing fees. MSRs, which are included in other assets, are considered Level 3 fair value measurements at September 30, 2008.

The following table presents the fair values of those financial assets measured at fair value on a non-recurring basis at September 30, 2008.

	Non-recurring Fair Value Measurements As of September 30, 2008			Total Losses For the Periods Ended September 30, 2008	
	Level 1	**Level 2**	**Level 3**	**Three Months**	**Nine Months**
Loans held-for-sale (1)			131,193	$ (13,602)	$ (29,851)
Mortgage servicing rights			1,256	$ (415)	$ (1,363)

(1) Includes $1.0 million and $130.2 million of loans held-for-sale within continuing and discontinued operations, respectively at September 30, 2008.

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The following tables represent changes in fair value of recurring fair value measurements for the three and nine months ended September 30, 2008.

Recurring Fair Value Measurements
Changes in Fair Value Included in Net Loss
Three Months Ended September 30, 2008

	Interest Income	Interest Expense	Change in Fair Value of Net Trust Assets	Change in Fair Value of Trust Preferred Securities	Total
Investment securities available-for-sale	$ 466	$	$ (3,092)	$	$ (2,626)
Securitized mortgage collateral	134,377		(2,391,349)		(2,256,972)
Securitized mortgage borrowings		(271,817)	2,413,109		2,141,292
Trust preferred securities		(126)		10,494	10,368
Derivative instruments			(10,890)		(10,890)
Total	**$ 134,843**	**$ (271,943)**	**$ 7,778**	**$ 10,494**	**$ (118,828)**

Recurring Fair Value Measurements
Changes in Fair Value Included in Net Loss
Nine Months Ended September 30, 2008

	Interest Income (1)	Interest Expense (1)	Change in Fair Value of Net Trust Assets	Change in Fair Value of Trust Preferred Securities	Total
Investment securities available-for-sale	$ 865	$	$ (8,899)	$	$ (8,034)
Securitized mortgage collateral	231,288		(5,639,914)		(5,408,626)
Securitized mortgage borrowings		(617,493)	5,743,357		5,125,864
Trust preferred securities		(419)		5,473	5,054
Derivative instruments			(94,399)(2)		(94,399)
Total	**$ 232,153**	**$ (617,912)**	**$ 145**(3)	**$ 5,473**	**$ (380,141)**

(1) Amounts represent interest income and interest expense accretion included in interest income and interest expense, respectively in the consolidated statement of operations and comprehensive loss.

(2) Included in this amount is $18.5 million in non-cash changes in the fair value of derivative instruments, which are included in the accompanying statement of cash flows for the nine months ended September 30, 2008.

(3) Excluded from the $113 million change in fair value of net trust assets, excluding REO in the accompanying consolidated statement of cash flows is $(112.9) million in cash settlements related to the Company s net derivative liabilities.

The change in fair value of the asset and liabilities above, excluding derivative instruments, are primarily due to the changes in credit risk. The change in fair value for derivative instruments is primarily due to the change in the forward LIBOR curve.

Note C Stock Options

The fair value of options granted, which is amortized to expense over the option vesting period, is estimated on the date of grant using the Black-Scholes-Merton option pricing model with the following weighted average assumptions:

	Nine Months Ended September 30,	
	2008	**2007**
Risk-free interest rate	1.88%to 2.54%	4.28% to 4.60%
Expected lives (in years)	3.25 - 3.50	3.00
Expected volatility (1)	87.3% - 91.9%	75.09%
Expected dividend yield (2)	0.00%	0.00%
Grant date fair value of share options	$0.50 - 0.78	$0.60

(1) Expected volatilities are based on the historical volatility of the Company s stock over the expected option life.

(2) Expected dividend yield is zero because a dividend on the common stock is currently not probable over the expected life of the options granted during the nine months ended September 30, 2008.

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The following table summarizes activity, pricing and other information for the Company s stock options for the nine-month period ended September 30, 2008:

	Number of Shares		Weighted-Average Exercise Price ($)
Options outstanding at January 1, 2008	5,939,914	$	9.75
Options granted	7,970,000		1.27
Options exercised			
Options forfeited / cancelled	(2,263,331)		11.25
Options outstanding at September 30, 2008	11,646,583	$	3.71
Options exercisable at September 30, 2008	3,025,057	$	8.66

As of September 30, 2008, there was approximately $4.7 million of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the plan. That cost is expected to be recognized over a weighted average period of 1.1 years.

Note D Reconciliation of Earnings Per Share

The following table presents the computation of basic and diluted net earnings per share including the dilutive effect of stock options and cumulative redeemable preferred stock outstanding for the periods indicated:

	For the Three Months Ended September 30,				For the Nine Months Ended September 30,			
		2008		2007		2008		2007
Numerator for basic earnings per share:								
Net earnings (loss) from continuing operations	$	1,901	$	(969,442)	$	(19,041)	$	(1,117,100)
Net loss from discontinued operations		(18,121)		(221,793)		(28,481)		(348,350)
Less: Cash dividends on cumulative redeemable preferred stock		(3,722)		(3,722)		(11,165)		(11,165)
Net loss available to common stockholders	$	(19,942)	$	(1,194,957)				