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MUNICIPAL MORTGAGE & EQUITY LLC

Form 10-Q

November 14, 2003

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2003

Commission File Number: 001-11981
MUNICIPAL MORTGAGE & EQUITY, LLC
(Exact name of registrant as specified in its charter)

DELAWARE
(State or other jurisdiction of
incorporation or organization)

52-1449733
(I.R.S. Employer Identification No.)

621 E. PRATT STREET, 3RD FLOOR
BALTIMORE, MARYLAND
(Address of principal executive offices)

21202-3140
(Zip Code)

(443) 263-2900
(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 No

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes No

The Registrant had 32,588,441 common shares outstanding as of November 7, 2003.

MUNICIPAL MORTGAGE & EQUITY, LLC
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FORWARD-LOOKING INFORMATION

Assumptions relating to various portions of the Company's Quarterly Report on Form 10-Q involve judgments with respect to, among other things, future economic market conditions and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond the control of the Company. Although the Company believes that the assumptions underlying the forward-looking information included herein are reasonable, any of the assumptions could be inaccurate and, therefore, there can be no assurance that such forward-looking information will prove to be accurate. In light of the significant uncertainties inherent in forward-looking information, the inclusion of such information should not be regarded as a representation by the Company or any other person that the objectives and plans of the Company will be achieved.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

MUNICIPAL MORTGAGE & EQUITY, LLC
CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT SHARE DATA)
(UNAUDITED)

ASSETS

Investment in tax-exempt bonds, net (Note 3)
Loans receivable, net (Note 4)
Loans receivable held for sale (Note 4)
Investments in partnerships (Notes 5 and 9)
Residual interests in bond securitizations (Note 6)
Investment in derivative financial instruments (Note 7)
Cash and cash equivalents
Interest receivable
Restricted assets
Other assets
Mortgage servicing rights, net
Goodwill and other intangibles

TOTAL ASSETS

LIABILITIES AND SHAREHOLDERS' EQUITY

Notes payable (Note 8)
Short-term debt (Note 8)
Long-term debt (Note 8)
Preferred shares subject to mandatory redemption (Note 10)

Sep

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Tax credit syndication guarantee liability (Note 9)
 Residual interests in bond securitizations (Note 4)
 Investment in derivative financial instruments (Note 5)
 Accounts payable and accrued expenses
 Interest payable
 Unearned revenue and other liabilities
 Distributions payable

TOTAL LIABILITIES

COMMITMENTS AND CONTINGENCIES (NOTE 11)

PREFERRED SHAREHOLDERS' EQUITY IN A SUBSIDIARY COMPANY (NOTE 10)

SHAREHOLDERS' EQUITY:

Common shares, par value \$0 (32,303,599 shares authorized, including 28,936,397 shares issued and outstanding, and 36,929 deferred shares at September 30, 2003 and 29,083,599 authorized, 25,571,580 shares issued and outstanding, and 29,844 deferred shares at December 31, 2002)
 Less common shares held in treasury at cost (124,715 and 55,444 at September 30, 2003 and December 31, 2002, respectively)
 Less unearned compensation (deferred shares) (Note 14)
 Accumulated other comprehensive income

TOTAL SHAREHOLDERS' EQUITY

TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY

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

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MUNICIPAL MORTGAGE & EQUITY, LLC
 CONSOLIDATED STATEMENTS OF INCOME
 (IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)
 (UNAUDITED)

| | For the three months September 30, | |
|--|---------------------------------------|-----------|
| | 2003 | 2002 |
| INCOME: | | |
| Interest income | | |
| Interest on bonds and residual interests in bond securitizations | \$ 15,612 | \$ 15,612 |
| Interest on loans | 9,408 | 9,408 |
| Interest on short-term investments | 308 | 308 |
| Total interest income | 25,328 | 25,328 |
| Fee income | | |
| Syndication fees | 5,764 | 5,764 |

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| | | |
|--|-----------|-------|
| Origination fees | 862 | |
| Loan servicing fees | 1,716 | |
| Asset management and advisory fees | 3,191 | |
| Other income | 3,582 | |
| | ----- | ----- |
| Total fee income | 15,115 | |
| | ----- | ----- |
| Net gain on sales | 8,288 | |
| | ----- | ----- |
| TOTAL INCOME | 48,731 | 3 |
| | ----- | ----- |
| EXPENSES: | | |
| Interest expense | 15,690 | |
| Salaries and benefits | 12,065 | |
| General and administrative | 3,385 | |
| Professional fees | 1,105 | |
| Amortization of intangibles | 2,863 | |
| | ----- | ----- |
| TOTAL EXPENSES | 35,108 | 1 |
| | ----- | ----- |
| Net holding gains (losses) on derivatives | 3,498 | (|
| Impairments and valuation allowances related to investments (Notes 3 and 4) | -- | |
| Net losses from equity investments in partnerships | (1,608) | (|
| | ----- | ----- |
| NET INCOME BEFORE INCOME TAXES, INCOME ALLOCATED TO PREFERRED SHAREHOLDERS IN A SUBSIDIARY COMPANY AND DISCONTINUED OPERATIONS | 15,513 | |
| Income tax benefit (expense) | 2,622 | |
| | ----- | ----- |
| NET INCOME BEFORE INCOME ALLOCATED TO PREFERRED SHAREHOLDERS IN A SUBSIDIARY COMPANY AND DISCONTINUED OPERATIONS | 18,135 | |
| Income allocable to preferred shareholders in a subsidiary company | -- | (|
| | ----- | ----- |
| NET INCOME FROM CONTINUING OPERATIONS | 18,135 | |
| Discontinued operations | -- | |
| | ----- | ----- |
| NET INCOME | \$ 18,135 | \$ |
| | ===== | ===== |
| NET INCOME ALLOCATED TO: | | |
| Term growth shares | \$ -- | \$ |
| | ===== | ===== |
| Common shares | \$ 18,135 | \$ |
| | ===== | ===== |

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

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| | For the three months ended September 30, | | |
|--|---|------------|----|
| | 2003 | 2002 | |
| BASIC EARNINGS PER COMMON SHARE: | | | |
| Net income from continuing operations | \$ 0.63 | \$ 0.01 | \$ |
| Discontinued operations | -- | -- | |
| Basic earnings per common share | \$ 0.63 | \$ 0.01 | \$ |
| Weighted average common shares outstanding | 28,842,447 | 25,329,103 | 2 |
| DILUTED EARNINGS PER COMMON SHARE: | | | |
| Net income from continuing operations | \$ 0.62 | \$ 0.01 | \$ |
| Discontinued operations | -- | -- | |
| Diluted earnings per common share | \$ 0.62 | \$ 0.01 | \$ |
| Weighted average common shares outstanding | 29,224,605 | 25,916,151 | 2 |
| CASH DISTRIBUTION PER COMMON SHARE | \$ 0.4500 | \$ 0.4400 | \$ |

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

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MUNICIPAL MORTGAGE & EQUITY, LLC
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(IN THOUSANDS)
(UNAUDITED)

| | For the three months ended September 30, | | |
|--|---|--------|------|
| | 2003 | 2002 | |
| NET INCOME | \$ 18,135 | \$ 237 | \$ 6 |
| Other comprehensive income (loss): | | | |
| Unrealized gains (losses) on investments: | | | |
| Unrealized holding gains (losses) arising during the period | (15,551) | 8,741 | (2) |
| Reclassification adjustment for gains included in net income | (2,194) | (221) | (2) |
| Other comprehensive income (loss) | (17,745) | 8,520 | (2) |

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| | | | |
|----------------------|--------|----------|-------|
| COMPREHENSIVE INCOME | \$ 390 | \$ 8,757 | \$ 4 |
| | ===== | ===== | ===== |

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

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MUNICIPAL MORTGAGE & EQUITY, LLC
CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)
(UNAUDITED)

CASH FLOWS FROM OPERATING ACTIVITIES:

Net income
Adjustments to reconcile net income to net cash provided by operating activities:
Income allocated to preferred shareholders
Net holding (gains) losses on trading securities
Impairments and valuation allowances related to investments
Amortization of guarantee liability
Net gain on sales
Loss on disposal of fixed assets
Loss from investments in partnerships
Distributions received from investments in partnerships
Net amortization of premiums, discounts and fees on investments
Depreciation and amortization
Discontinued operations
Deferred income taxes
Tax benefit from deferred share compensation
Deferred share compensation expense
Common and deferred shares issued under the Non-Employee Directors' Share Plans
Net change in assets and liabilities:
Increase in interest receivable
Increase in other assets
Increase (decrease) in accounts payable, accrued expenses and other liabilities

NET CASH PROVIDED BY OPERATING ACTIVITIES

CASH FLOWS FROM INVESTING ACTIVITIES:

Purchases of tax-exempt bonds and residual interests in bond securitizations
Loan originations
Acquisition of HCI
Acquisition of an unconsolidated subsidiary
Purchases of property and equipment
Net investment in restricted assets
Principal payments received
Investments in partnerships
Return of capital invested in partnerships
Termination of derivative financial instruments
Proceeds from sales of investments

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NET CASH USED IN INVESTING ACTIVITIES

CASH FLOWS FROM FINANCING ACTIVITIES:

Borrowings from credit facilities
Repayment of credit facilities
Proceeds from tax credit syndication investors
Proceeds from short-term debt
Repayment of short-term debt
Proceeds from long-term debt
Repayment of long-term debt
Issuance of common shares
Redemption of preferred shares
Proceeds from stock options exercised
Distributions on common shares
Distributions to preferred shareholders in a subsidiary company

NET CASH PROVIDED BY FINANCING ACTIVITIES

NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS

CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD

CASH AND CASH EQUIVALENTS AT END OF PERIOD

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

MUNICIPAL MORTGAGE & EQUITY, LLC
CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)
(UNAUDITED)

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:

Interest paid

Income taxes paid

DISCLOSURE OF NON-CASH ACTIVITIES:

Issuance of common stock in connection with the acquisition of an
unconsolidated subsidiary

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

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MUNICIPAL MORTGAGE & EQUITY, LLC
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
(IN THOUSANDS, EXCEPT SHARE DATA)
(UNAUDITED)

| | COMMON SHARES | TREASURY SHARES | UNEARNED COMPENSATION |
|---|------------------|--------------------|--------------------------|
| | ----- | ----- | ----- |
| BALANCE, JANUARY 1, 2003 | \$ 471,946 | \$ (857) | \$ (3,274) |
| Net income | 63,182 | -- | -- |
| Unrealized gains on investments, net of reclassifications | -- | -- | -- |
| Distributions | (37,161) | -- | -- |
| Purchase of treasury shares | 1,758 | (1,758) | -- |
| Options exercised | 1,180 | -- | -- |
| Issuance of common shares | 71,899 | -- | -- |
| Deferred shares issued under the Non-Employee Directors' Share Plans (Note 14) | 173 | -- | -- |
| Deferred share grants (Note 14) | 2,000 | -- | (2,000) |
| Forfeiture of deferred shares | (452) | -- | 452 |
| Amortization of deferred compensation (Note 14) | -- | -- | 1,428 |
| Tax benefit from exercise of options and vesting of deferred shares | 242 | -- | -- |
| | ----- | ----- | ----- |
| BALANCE, SEPTEMBER 30, 2003 | \$ 574,767 | \$ (2,615) | \$ (3,394) |
| | ===== | ===== | ===== |

| | COMMON SHARES | TREASURY SHARES |
|---|------------------|--------------------|
| | ----- | ----- |
| SHARE ACTIVITY: | | |
| BALANCE, JANUARY 1, 2003 | 25,545,980 | 55,444 |
| Options exercised | 64,250 | -- |
| Purchase of treasury shares | (69,271) | 69,271 |
| Issuance of common shares | 3,221,148 | -- |
| Issuance of common shares under employee share incentive plans (Note 14) | 79,419 | -- |
| Deferred shares issued under the Non-Employee Directors' Share Plans (Note 14) | 7,085 | -- |
| | ----- | ----- |
| BALANCE, SEPTEMBER 30, 2003 | 28,848,611 | 124,715 |
| | ===== | ===== |

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

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1 - BASIS OF PRESENTATION

Municipal Mortgage & Equity, LLC ("MUNIMAE" and, together with its subsidiaries, the "COMPANY") provides debt and equity financing to developers of multifamily housing. The Company invests in tax-exempt bonds, or interests in bonds, issued by state and local governments or their agencies or authorities to finance multifamily housing developments. Although these tax-exempt bonds are not general obligations of state and local governments, or the agencies or authorities that issue the bonds, the bonds are secured by the rents and other revenues of the housing developments financed by the bonds and by the underlying real estate. Interest income derived from the majority of these bond investments is exempt income for federal income tax purposes.

The Company is also a mortgage banker. Mortgage banking activities include the origination, investment in and servicing of investments in multifamily housing, both for its own account and on behalf of third parties. These investments generate taxable income.

The Company also acquires and sells interests in partnerships that provide low-income housing tax credits for investors. The Company earns syndication fees on the placement of these interests with investors. The Company also earns guarantee fees for providing guarantees on certain tax credit funds and asset management fees for managing the low-income housing tax credit funds it has syndicated.

The Company also invests in other housing-related debt and equity investments, including equity investments in income-producing real estate operating partnerships and tax-exempt bonds, or interests in bonds, secured by student housing or assisted living developments, and tax-exempt community development bonds, typically secured by special taxes imposed on single-family or other community development districts or by assessments imposed on the residents or other owners of lots in those developments.

MuniMae is a Delaware limited liability company. As a limited liability company, MuniMae combines the limited liability, governance and management characteristics of a corporation with the pass-through income features of a partnership. Since MuniMae is classified as a partnership for federal income tax purposes, no recognition of income taxes is made at the corporate level (except for income earned through subsidiaries of the Company organized as corporations). Instead, the distributive share of MuniMae's income, deductions and credits is included in each shareholder's income tax return.

The accompanying unaudited consolidated financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission and in the opinion of management contain all adjustments (consisting of only normal recurring accruals) necessary to present a fair statement of the results for the periods presented. These results have been

determined on the basis of accounting principles and policies discussed in Note 1 to the Company's Annual Report on Form 10-K for the year ended December 31, 2002 (the "COMPANY'S 2002 FORM 10-K"). Certain information and footnote disclosures normally included in financial statements presented in accordance with generally accepted accounting principles ("GAAP") have been condensed or omitted. The accompanying financial statements should be read in conjunction with the financial statements and notes thereto included in the Company's 2002

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Form 10-K. Certain 2002 amounts have been reclassified to conform to the 2003 presentation.

The Company posts all Securities and Exchange Commission reports on their website at <http://www.mmafin.com>. These reports are also available free of charge by contacting Angela Richardson in Investor Relations at 621 E. Pratt Street, 3rd Floor, Baltimore, Maryland, 21202 or 888-788-3863.

NEW ACCOUNTING PRONOUNCEMENTS

In May 2003, the Financial Accounting Standards Board approved Statement of Financial Accounting Standards No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity" ("FAS 150"). FAS 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify financial instruments with certain debt-like characteristics as liabilities. The scope of FAS 150 includes financial instruments issued in the form of mandatorily redeemable shares. These types of shares embody an unconditional obligation requiring the issuer to redeem them by transferring assets at a specified date. Management has determined that the Company's preferred shareholders' equity in a subsidiary company falls within the scope of FAS 150. Therefore, for the third quarter of 2003, the Company has reclassified the liquidation preference value of its preferred shareholders' equity of \$168.0 million to a separate line in the liability section of the consolidated balance sheets. In addition, offering costs of \$7.5 million related to these preferred shares have been reclassified to other assets and are being amortized through the mandatory tender dates of the preferred shares. Amounts previously classified as distributions to preferred shareholders are now recorded as interest expense.

In January 2003, the Financial Accounting Standards Board approved Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46"). FIN 46 requires the consolidation of a company's equity investment in a variable interest entity ("VIE") if the company is the primary beneficiary of the VIE and if risks are not effectively dispersed among the owners of the VIE. The company is considered to be the primary beneficiary of the VIE if the company absorbs the majority of the losses of the VIE. FIN 46 is effective for VIEs created after January 31, 2003. For any VIE in which the Company held an interest that it acquired before February 1, 2003, FIN 46 was effective for the first interim reporting period beginning after June 15, 2003. The Financial Accounting Standards Board has extended the effective date until the first reporting period ending after December 15, 2003 and the Company has elected to defer adoption of FIN 46 until that time. The Company is currently reviewing the impact of FIN 46 on the tax credit syndication funds that a wholly owned subsidiary of the Company sponsors and asset manages, as well as investments

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accounted for under the equity method of accounting. The Company will continue to review new investments in order to determine if they should be accounted for in accordance with FIN 46.

NOTE 2 - ACQUISITION

On July 1, 2003, the Company acquired the Housing and Community Investing ("HCI") business of Lend Lease Real Estate Investments for \$102 million in cash. Through the integration of HCI's affordable housing tax credit syndication operation into MuniMae's existing operations, the Company becomes one of the nation's largest players in the affordable housing industry. The acquisition, along with working capital needs, was financed by a \$120 million secured term credit facility provided by a syndicate of banks led by the Royal

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Bank of Canada. HCI is a syndicator of low income housing tax credit equity investments. The HCI business is owned by MMA Financial TC Corp. ("TC CORP"), a wholly owned subsidiary of the Company, and the Company's results for the third quarter of 2003 reflect a full quarter of activity from TC Corp. In connection with this acquisition, the Company's operating subsidiary, MuniMae Midland, LLC, has been renamed MMA Financial, LLC.

The acquisition is being accounted for as a purchase. The total purchase price was \$105 million, which includes acquisition costs. The cost of the acquisition was allocated on the basis of the estimated fair value of the assets acquired and liabilities assumed, as summarized below:

PURCHASE OF HCI
SUMMARY OF NET ASSETS
(IN THOUSANDS)
(UNAUDITED)

| | Total |
|---|------------------|
| | ----- |
| ASSETS | |
| Investments in partnerships | \$102,921 |
| Restricted assets | 46,712 |
| Other assets | 20,033 |
| Asset Management Contracts | 32,004 |
| Goodwill | 68,233 |
| | ----- |
| TOTAL ASSETS | 269,903 |
| | ----- |
| LIABILITIES AND SHAREHOLDERS' EQUITY | |
| Tax credit syndication guarantee liability | 148,394 |
| Accounts payable and accrued expenses | 3,894 |
| Unearned revenue and other liabilities | 12,190 |
| | ----- |
| TOTAL LIABILITIES | 164,478 |
| | ----- |
| NET CASH PAID | \$105,425 |
| | ===== |

The Company assigned \$32.0 million to asset management contracts. These intangible

assets are subject to amortization and have a weighted average useful life of 2.5 years. For the three months ended September 30, 2003, the Company recognized \$2.4 million of amortization expense and the unamortized balance of the asset management contracts was \$29.6 million at September 30, 2003. The estimated amortization expense on the asset management contracts for the succeeding five years is as follows:

(000s)

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| | |
|------|---------|
| 2004 | \$4,716 |
| 2005 | 4,188 |
| 2006 | 3,604 |
| 2007 | 3,130 |
| 2008 | 2,724 |

The following unaudited pro forma data summarizes the results of operations for the periods indicated as if the HCI acquisition had been completed as of the beginning of the periods presented. The pro forma data gives effect to actual operating results prior to the acquisition, adjusted to include the pro forma effect of amortization of intangibles. These pro forma amounts do not purport to be indicative of the results that would have actually been obtained if the acquisition occurred as of the beginning of the periods presented or that may be obtained in the future.

| (000s, except per share data) | For the three months ended September 30, | | For the nine months ended September 30, | |
|-------------------------------|--|-----------|---|------------|
| | 2003 | 2002 | 2003 | 2002 |
| Total Income | \$ 48,731 | \$ 46,549 | \$137,935 | \$ 133,543 |
| Net Income | 18,135 | 2,775 | 63,615 | 24,002 |
| Earnings per share: | | | | |
| Basic | \$ 0.63 | \$ 0.11 | \$ 2.24 | \$ 0.96 |
| Diluted | 0.62 | 0.11 | 2.22 | 0.94 |

NOTE 3 - INVESTMENT IN TAX-EXEMPT BONDS

The Company originates investments in tax-exempt bonds and taxable loans primarily to the affordable multifamily housing industry. Tax-exempt bonds are issued by state and local government authorities to finance multifamily housing developments or other real estate financings. The bonds are typically secured by nonrecourse mortgage loans or tax levies on the underlying properties. The Company's sources of capital to fund these lending activities include proceeds from equity offerings, debt financings, securitizations and lines of credit. The Company earns interest income from its investment in tax-exempt bonds and taxable loans. The Company also earns origination and construction administration fees from originating the bonds and servicing the bonds during the construction period. For further discussion of the general terms of tax-exempt bonds see Note 1 to the Company's 2002 Form 10-K.

As of September 30, 2003 and December 31, 2002, the Company held \$792.3 million and

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\$770.3 million of tax-exempt bonds, respectively. The following table summarizes tax-exempt bonds by type.

| (000s) | September 30, 2003 | | | |
|--------|--------------------|----------------|------------------------|------------|
| | Face Amount | Amortized Cost | Unrealized Gain (Loss) | Fair Value |
| | | | | |

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| | ----- | ----- | ----- | ----- |
|-------------------------------------|-----------|-----------|-------------|-----------|
| Non-participating bonds | \$682,012 | \$665,266 | \$ (21,401) | \$643,865 |
| Participating bonds | 82,608 | 81,712 | (1,816) | 79,896 |
| Subordinate non-participating bonds | 18,965 | 17,626 | 134 | 17,760 |
| Subordinate participating bonds | 58,890 | 35,799 | 15,012 | 50,811 |
| | ----- | ----- | ----- | ----- |
| Total | \$842,475 | \$800,403 | \$ (8,071) | \$792,332 |
| | ===== | ===== | ===== | ===== |

| | December 31, 2002 | | | |
|-------------------------------------|-------------------|-------------------|---------------------------|---------------|
| (000s) | Face Amount | Amortized Cost | Unrealized Gain (Loss) | Fair Value |
| | ----- | ----- | ----- | ----- |
| Non-participating bonds | \$651,737 | \$621,594 | \$ (4,692) | \$616,902 |
| Participating bonds | 82,852 | 81,956 | 1,893 | 83,849 |
| Subordinate non-participating bonds | 19,039 | 17,700 | 106 | 17,806 |
| Subordinate participating bonds | 58,890 | 35,799 | 15,989 | 51,788 |
| | ----- | ----- | ----- | ----- |
| Total | \$812,518 | \$757,049 | \$ 13,296 | \$770,345 |
| | ===== | ===== | ===== | ===== |

During the third quarter of 2003, the Company invested in tax-exempt bonds with a face amount of \$24.6 million for \$23.7 million. These investments represent new primary investments (bonds which the Company originated).

The Company invested an additional \$17.9 million in existing tax-exempt draw down bonds with a face amount of \$17.9 million. Since the end of 2002, the Company has structured tax-exempt bonds that allow the borrower to make draws on the bonds throughout the construction period. The initial draws on these bonds have been reported as new primary investments in prior quarters.

The Company also purchased a tax-exempt bond with a face amount of \$9.5 million for \$9.5 million from the secondary market.

The Company sold two tax-exempt bonds with a face amount of \$21.3 million for a \$2.2

million gain in the third quarter of 2003.

In order to facilitate the securitization of certain assets at higher leverage ratios than otherwise available, the Company has pledged additional bonds as collateral for senior interests in certain securitization trusts and credit enhancement facilities. See Note 1 to the Company's 2002 Form 10-K for a description of securitizations. At September 30, 2003 and December 31, 2002, the

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total carrying amount of the tax-exempt bonds pledged as collateral for such trusts and facilities was \$368.7 million and \$372.9 million, respectively.

NOTE 4 - LOANS RECEIVABLE

The Company's loans receivable consist primarily of construction loans, permanent loans, supplemental loans and other taxable loans. For further discussion of the general terms of loans held by the Company and the allowance for loan losses see the description of mortgage banking activities in Note 1 to the Company's 2002 Form 10-K. The following table summarizes loans receivable by loan type at September 30, 2003 and December 31, 2002.

| (in thousands) | SEPTEMBER 30, 2003 ----- | DECEMBER 31, 2002 ----- |
|---------------------------|-----------------------------|----------------------------|
| Loan Type: | | |
| Construction loans | \$ 361,455 | \$ 300,266 |
| Supplemental loans | 82,326 | 80,459 |
| Other taxable loans | 30,248 | 42,646 |
| | ----- | ----- |
| | 474,029 | 423,371 |
| Allowance for loan losses | (1,409) | (1,072) |
| | ----- | ----- |
| TOTAL | \$ 472,620 ===== | \$ 422,299 ===== |

The Company has loans receivable held for sale of \$9.1 million and \$39.1 million at September 30, 2003 and December 31, 2002, respectively. These loans are sold to Fannie Mae and third party conduit lenders. Due to the short time the Company holds these loans, carrying value approximates fair value.

The Company pledges its construction loans, permanent loans and supplemental loans as collateral for the Company's notes payable and line of credit borrowings. In addition, in order to facilitate the securitization of certain assets at higher leverage ratios than otherwise available, the Company has pledged additional taxable loans to a pool that acts as collateral for senior interests in certain securitization trusts and credit enhancement facilities. At September 30, 2003 and December 31, 2002, the total carrying amount of the loans receivable pledged as collateral was \$436.1 million and \$417.1 million, respectively.

NOTE 5 - INVESTMENT IN PARTNERSHIPS

The Company's investments in partnerships consist of equity interests in real estate operating

partnerships. The Company's investments in partnerships are accounted for using the equity method and are recorded as "Investments in partnerships" on the Balance Sheet. A complete discussion of the Company's investments in partnerships is contained in Note 4 to the Company's 2002 Form 10-K.

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| | | |
|--|-----------|-----------|
| Guaranteed tax credit equity funds: | | |
| Investment in real estate operating partnerships (1) | \$102,377 | \$ -- |
| Tax credit equity funds: | | |
| Investment in real estate operating partnerships (2) | 69,267 | 29,798 |
| Investment in CAPREIT | 60,727 | 69,290 |
| Other investments in partnerships | 661 | 878 |
| | ----- | ----- |
| | \$233,032 | \$ 99,966 |
| | ===== | ===== |

(1) These investments are real estate operating partnerships owned by tax credit funds where the Company provides a guarantee or otherwise has continuing involvement in the underlying assets of the fund. As a result, the Company includes the assets of the funds in its consolidated balance sheets.

(2) The Company acquires, through limited partnership interests, equity interests in properties expected to earn tax credits and, as and when it has a sufficient number of such limited partnership interests and has identified tax credit investors, transfers those interests to a syndicated fund for the investors' benefit. The Company typically owns these partnership interests for three to nine months before they are transferred to a fund.

NOTE 6 - RESIDUAL INTERESTS IN BOND SECURITIZATIONS

At September 30, 2003 and December 31, 2002, the Company's residual interests in bond securitizations are investments in Residual Interest Tax-Exempt Securities Receipts ("RITES(SM)"). For further discussion of the Company's securitization programs see Note 1 to the Company's 2002 Form 10-K. The following table provides certain information with respect to the residual interests in bond securitizations held by the Company at September 30, 2003 and December 31, 2002.

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| | | | | | |
|---------------------|--------------------|-----------|-------------|----------------|-----------------|
| | September 30, 2003 | | | | |
| | Face | Amortized | Unrealized | Fair Value (1) | |
| (000s) | Amount | Cost | Gain (Loss) | Assets | Liabilities (2) |
| | ----- | ----- | ----- | ----- | ----- |
| Total RITES(SM) (3) | \$ 335 | \$ 4,054 | \$ 5,965 | \$11,944 | \$(1,925) |
| | ===== | ===== | ===== | ===== | ===== |

| | | | | | |
|--------|-------------------|-----------|-------------|----------------|-----------------|
| | December 31, 2002 | | | | |
| | Face | Amortized | Unrealized | Fair Value (1) | |
| (000s) | Amount | Cost | Gain (Loss) | Assets | Liabilities (2) |
| | ----- | ----- | ----- | ----- | ----- |

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| | | | | | |
|---------------------|--------|----------|----------|----------|-----------|
| Total RITES(SM) (3) | \$ 334 | \$ 3,639 | \$ 5,953 | \$11,039 | \$(1,447) |
| | ===== | ===== | ===== | ===== | ===== |

(1) The amounts disclosed represent the fair values of all the Company's investments in residual interests in bond securitizations at the reporting date.

(2) The aggregate negative fair value of the investments is included in liabilities for financial reporting purposes. The negative fair value of these investments is considered temporary and is not indicative of the future earnings on these investments.

(3) The amount of outstanding Puttable Floating Option Tax-Exempt Receipts ("P-FLOATS(SM)"), which are senior to the Company's RITES(SM) investments and which are not reflected in the Company's balance sheet, was \$192.5 million and \$177.8 million at September 30, 2003 and December 31, 2002, respectively.

The Company purchased \$5,000 (face amount) of RITES(SM) for \$68,000 in the third quarter of 2003.

RITES(SM) Valuation Analysis

The fair value of a RITES(SM) investment is derived from the quote on the underlying bond reduced by the outstanding corresponding P-FLOATS(SM) face amount. The Company bases the fair value of the underlying bond, which has a limited market, on quotes from external sources, such as brokers, for these or similar bonds. The fair value of the underlying bond includes a prepayment risk factor. The prepayment risk factor is reflected in the fair value of the bond by assuming the bond will prepay at the most adverse time to the Company given current market rates and estimates of future market rates. Based on this, an adverse change in prepayment risk would not have an effect on the fair value of the Company's RITES(SM) investments. In addition, the RITES(SM) investments are not subject to prepayment risk as the term of the securitization trusts is only for a period during which the underlying bond cannot be prepaid. Based on historical experience, credit losses were estimated to be zero.

At September 30, 2003 and December 31, 2002, a 10% and 20% adverse change in key assumptions used to estimate the fair value of the Company's RITES(SM) would have the following impact.

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| (000s) | September 30, 2003 ----- | December 31, 2002 ----- |
|---|-----------------------------|----------------------------|
| Fair value of retained interests, net | \$ 10,019 | \$ 9,592 |
| Residual cash flows discount rate (annual rate) | 1.9% - 9.2% | 3.8% - 8.1% |
| Impact on fair value of 10% adverse change | (\$ 5,826) | (\$ 9,108) |
| Impact on fair value of 20% adverse change | (\$ 11,282) | (\$ 17,444) |

The sensitivity analysis presented above is hypothetical in nature and presented for information purposes only. The analysis shows the effect on fair value of a variation in one assumption and is calculated without considering the effect of changes in any other assumption. In reality, changes in one assumption may affect the others, which may magnify or offset the sensitivities.

NOTE 7 - INVESTMENT IN DERIVATIVE FINANCIAL INSTRUMENTS

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At September 30, 2003 and December 31, 2002, the Company's investments in derivative financial instruments consisted of interest rate swaps and put option contracts. For further discussion of the Company's investment in derivative financial instruments see Note 6 to the Company's 2002 Form 10-K. The following table provides certain information with respect to the derivative financial instruments held by the Company at September 30, 2003 and December 31, 2002:

| (000s) | September 30, 2003 | | | No |
|--|------------------------|----------|-----------------------------------|----|
| | Notional Amount (1) | Assets | Fair Value (2) Liabilities (3) | |
| Interest rate swap agreements | \$ 310,975 | \$ 2,755 | \$ (17,879) | \$ |
| Written put option agreements | 97,314 | -- | -- | |
| | | ----- | ----- | |
| Total investment in derivative financial instruments | | \$ 2,755 | \$ (17,879) | |
| | | ===== | ===== | |

(1) For the interest rate swap agreements, notional amount represents total amount of the Company's interest rate swap contracts (\$345,935 as of September 30, 2003 and \$598,415 as of December 31, 2002) less the total amount of the Company's reverse interest rate swap contracts (\$34,960 as of September 30, 2003 and \$248,605 as of December 31, 2002). For put option agreements, the notional amount represents the Company's aggregate obligation under the put option agreements.

(2) The amounts disclosed represent the net fair values of all the Company's derivatives at the reporting date.

(3) The aggregate negative fair value of the investments is included in liabilities for financial reporting purposes. The negative fair value of these investments is considered temporary and is not indicative of the future earnings on these investments.

NOTE 8 - NOTES PAYABLE AND DEBT

The Company's notes payable consist primarily of notes payable and advances under line of credit arrangements, which are used to: (1) finance construction lending needs; (2) finance working capital needs; (3) warehouse real estate operating partnerships before they are placed into tax credit equity funds; and (4) warehouse permanent loans before they are sold. The Company's short- and long-term debt relates to securitization transactions that the Company has recorded as borrowings (see Notes 1 and 9 to the Company's 2002 Form 10-K). The following table summarizes notes

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payable and debt at September 30, 2003 and December 31, 2002.

| (000s) | Total of Facilities | September 30, 2003 | Decembe |
|--------------------------|---------------------|--------------------|---------|
| Short-term notes payable | N/A | \$ 221,360 | \$ |

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| | | | | |
|---|----|---------|---------|-------|
| Lines of credit - unaffiliated entities | \$ | 445,000 | 247,406 | |
| Lines of credit - affiliated entities | \$ | 240,000 | 18,903 | |
| Short-term debt | | N/A | 191,835 | |
| | | | ----- | ----- |
| Total short-term notes payable and debt | | | 679,504 | |
| | | | ----- | ----- |
| Long-term notes payable | | N/A | 121,837 | |
| Long-term debt | | N/A | 155,448 | |
| | | | ----- | ----- |
| Total long-term notes payable and debt | | | 277,285 | |
| | | | ----- | ----- |
| Total notes payable and debt | \$ | | 956,789 | \$ |
| | | | ===== | ===== |

Covenant Compliance

Under the terms of the various credit facilities, the Company is required to comply with covenants including net worth, interest coverage, collateral and other terms and conditions. The Company was in compliance with its debt covenants or has obtained waivers for events of non-compliance at September 30, 2003.

NOTE 9 - TAX CREDIT EQUITY GUARANTEE LIABILITY

As part of the acquisition of HCI, the Company is providing guarantees to Lend Lease related to certain tax credit equity syndication funds where Lend Lease is providing a guarantee to investors or a third party. As a result of the guarantees, the Company is considered to have continuing involvement with the assets of the related tax credit equity funds and to have effective control over the assets in the funds. Therefore, the Company accounts for its involvement in these funds under the financing method. Under the financing method, the Company reports the assets of the funds, consisting primarily of restricted cash and investments in partnerships, in the Company's consolidated balance sheet. In addition, the investor capital contributions are reported as a tax credit equity guarantee liability on the Company's consolidated balance sheet. The net income (loss) from the tax credit equity funds are reported in the appropriate line items of the Company's consolidated statements of income. The tax credit equity guarantee liability is relieved as the guarantees expire or is amortized into income over the life of the guarantee and reported in other income in the Company's consolidated statements of income. The following table shows the changes in the tax credit equity guarantee liability since the acquisition of HCI:

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(000s)

| | | | |
|---|----|----------|-------|
| Assumed fund guarantee liability in purchase of HCI | \$ | 148,394 | |
| Amortization | | (1,076) | |
| Expiration of guarantees | | (13,332) | |
| Limited Partner's capital contributions | | 15,319 | |
| | | | ----- |
| Balance, September 30, 2003 | \$ | 149,305 | \$ |
| | | | ===== |

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NOTE 10 - PREFERRED SHARES SUBJECT TO MANDATORY REDEMPTION

As a result of the adoption of FAS 150 (discussed in Note 1), the Company has reclassified the liquidation preference value of its preferred shareholders' equity of \$168.0 million to a separate line in the liability section of the consolidated balance sheets. In addition, offering costs of \$7.5 million related to these preferred shares have been reclassified to other assets and are being amortized through the mandatory tender dates of the preferred shares. Amounts previously classified as income allocable to preferred shareholders are now recorded as interest expense.

At September 30, 2003 and December 31, 2002, the Company had four classes of preferred shares outstanding: Series A Cumulative Preferred Shares ("SERIES A PREFERRED SHARES"), Series B Cumulative Preferred Shares ("SERIES B PREFERRED SHARES"), Series A-1 Cumulative Preferred Shares ("SERIES A-1 PREFERRED SHARES") and Series B-1 Subordinate Cumulative Preferred Shares ("SERIES B-1 PREFERRED SHARES"); all four Series, collectively, the "TE BOND SUB PREFERRED SHARES". The following discussion summarized the significant terms of the TE Bond Sub Preferred Shares.

The Series A and A-1 Preferred Shares bear interest at 6.875% and 6.30% per annum, respectively, or, if lower, the aggregate net income of TE Bond Sub. The Series A and A-1 Preferred Shares have a senior claim to the income derived from the investments owned by TE Bond Sub. The Series A-1 Preferred Shares are equal in priority of payment to the Series A Preferred Shares. The Series B and B-1 Preferred Shares bear interest at 7.75% and 6.80% per annum, respectively, or, if lower, the aggregate net income of TE Bond Sub, after interest payments distributions to the Series A and Series A-1 Preferred Shares. The Series B-1 Preferred Shares are equal in priority of payment to the Series B Preferred Shares. Any income from TE Bond Sub available after payment of the cumulative distributions of the TE Bond Sub Preferred Shares is allocated to the Common Shares. Cash distributions on the TE Bond Sub Preferred Shares will be paid quarterly on each January 31, April 30, July 31 and October 31. The TE Bond Sub Preferred Shares are subject to remarketing on specified dates as indicated in the table below. On the remarketing date, the remarketing agent will seek to remarket the shares at the lowest distribution rate that would result in a resale of the TE Bond Sub Preferred Shares at a price equal to par plus all accrued but unpaid distributions. The TE Bond Sub Preferred Shares will be subject to mandatory tender on specified dates, as indicated below, and on all subsequent remarketing dates at a price equal to par plus all accrued but unpaid distributions. The following table provides a summary of certain terms of the TE Bond Sub Preferred Shares.

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| | Series A Preferred Shares ----- | Series A-1 Preferred Shares ----- | Series B Preferred Shares ----- |
|------------------------|---------------------------------------|---|---------------------------------------|
| Issue date | May 27, 1999 | October 9, 2001 | June 2, 2000 |
| Number of shares | 42 | 8 | 30 |
| Par amount per share | \$2,000,000 | \$2,000,000 | \$2,000,000 |
| Dividend rate | 6.875% | 6.30% | 7.75% |
| First remarketing date | June 30, 2009 | June 30, 2009 | November 1, 2010 |
| Mandatory tender date | June 30, 2009 | June 30, 2009 | November 1, 2010 |
| Redemption date | June 30, 2049 | June 30, 2049 | June 30, 2050 |

NOTE 11 - GUARANTEES, COMMITMENTS AND CONTINGENCIES

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For discussion of the Company's commitments and contingencies see Note 11 to the Company's 2002 Form 10-K.

Guarantees

The Company's maximum exposure under its guarantee obligations is not indicative of the likelihood of the expected loss under the guarantees. The Company recognizes contingent liabilities on guarantees when the losses are probable and can be reasonably estimated.

The following table summarizes the Company's guarantees by type at September 30, 2003.

| (in millions) | SEPTEMBER 30, 2003 | | | |
|---|--------------------|---------------------|--------------------|--|
| GUARANTEE | NOTE | MAXIMUM EXPOSURE | CARRYING AMOUNT | SUPPORTING COLLATERAL |
| Loss-Sharing Agreement with Fannie Mae and GNMA/HUD | (1) | \$ 171.3 | \$ - | \$5.1 million Letter of Credit |
| Bank Line of Credit Guarantees | (2) | 266.9 | - | Investments in partnerships common stock totaling \$52 |
| Tax Credit Related Guarantees | (3) | 273.1 | 149.5 | \$1.3 million of cash |
| Other Financial/Payment Guarantees | (4) | 254.6 | 1.3 | \$3.8 million of tax-exempt |
| Put Options | (5) | 97.3 | - | \$26.2 million of loans and |
| Letter of Credit Guarantees | (6) | 35.6 | - | \$1.1 million of tax-exempt |
| Indemnification Contracts | (7) | 15.2 | - | None |
| | | \$1,114.0 | \$150.8 | |
| | | ===== | ===== | |

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Notes:

- (1) As a Federal National Mortgage Association ("FANNIE MAE") DUS lender and Government National Mortgage Association ("GNMA") loan servicer, the Company may share in losses relating to underperforming real estate mortgage loans delivered to Fannie Mae and GNMA. More specifically, if the borrower fails to make a payment on a DUS loan originated by the Company and sold to Fannie Mae, of principal, interest, taxes or insurance premiums, the Company may be required to make servicing advances to Fannie Mae. Also, the Company may participate in a deficiency after foreclosure on DUS and GNMA loans. As a DUS lender, the Company must maintain a minimum net worth and collateral with a custodian. The term of the loss sharing agreement is based on the contractual requirements of the underlying loans delivered to Fannie Mae and GNMA, which varies to a maximum of 40 years.
- (2) The Company provides payment or performance guarantees for certain borrowings under line of credit facilities with a term of one year or less. The amount outstanding under these lines of credit is \$266.3 million at September 30, 2003. This amount is included in notes payable in the Company's consolidated balance sheet.
- (3) The Company acquires and sells interests in partnerships that provide

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low-income housing tax credits for investors. In conjunction with the sale of these partnership interests, the Company may provide performance guarantees on the underlying properties owned by the partnerships or guarantees to the fund investors. These guarantees have various expirations to a maximum term of 18 years.

- (4) The Company has entered into arrangements that require the Company to make payment in the event a specified third party fails to perform on its financial obligation. The Company typically provides these guarantees in conjunction with the sale of an asset to a third party or the Company's investment in equity ventures. The term of the guarantee varies based on loan payoff schedules or Company divestitures.
- (5) The Company has entered into put option agreements with counterparties whereby the counterparty has the right to sell to the Company, and the Company has the obligation to buy, an underlying investment at a specified price. These put option agreements expire at various dates between February 1, 2006 and April 1, 2007.
- (6) The Company provides a guarantee of the repayment on losses incurred under letters of credit issued by third parties or provide a guarantee to provide substitute letters of credit at a predetermined future date. In addition, the Company may provide a payment guarantee for certain assets in securitization programs. These guarantees expire at various dates between March 1, 2004 and September 1, 2007.
- (7) The Company has entered into indemnification contracts, which require the guarantor to make payments to the guaranteed party based on changes in an underlying investment that is related to an asset or liability of the guaranteed party. These agreements typically require the Company to reimburse the guaranteed party for legal and other costs in the event of an adverse judgment in a lawsuit or the imposition of additional taxes due to a change in the tax law or an adverse interpretation of the tax law. The term of the indemnification varies based on the underlying program life, loan payoffs, or Company divestitures. Based on the terms of the underlying contracts, the maximum exposure amount only includes amounts that can be reasonably estimated at this time; the actual exposure amount could vary significantly.

NOTE 12 - EARNINGS PER SHARE

The following table reconciles the numerators and denominators in the basic and diluted earnings per share ("EPS") calculations for common shares for the three and nine months ended September 30, 2003 and 2002. The Company had 30,000 options to purchase common shares that were not included in the computation of diluted EPS at September 30, 2003 due to the options' exercise prices being greater than the average price of the common shares for the period. The effect of all potentially dilutive securities was included in the calculation for September 30, 2002.

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| (IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA) | For the three months ended September 30, 2003 Income (Numerator) | Shares (Denominator) | Per Share Amount | For the thr Income (Numerator) |
|---|--|-------------------------|---------------------|--------------------------------------|
| | ----- | ----- | ----- | ----- |

BASIC EPS

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| | | | | | | | | |
|---------------------------------------|----|--------|------------|----|-------|--|----|-------|
| Net income from continuing operations | \$ | 18,135 | | \$ | 0.63 | | \$ | 237 |
| Discontinued operations | | -- | | | -- | | | -- |
| | | ----- | | | ----- | | | ----- |
| Income allocable to common shares | \$ | 18,135 | 28,842,447 | \$ | 0.63 | | \$ | 237 |
| | | ===== | | | ===== | | | ===== |

EFFECT OF DILUTIVE SECURITIES

| | | | | | |
|-----------------------------|--|--|---------|--|-------|
| Options and deferred shares | | | 382,158 | | |
| Earnings contingency | | | -- | | ----- |

DILUTED EPS

| | | | | | | | | |
|---|----|--------|------------|----|-------|--|----|-------|
| Net income from continuing operations | \$ | 18,135 | | \$ | 0.62 | | \$ | 237 |
| Discontinued operations | | -- | | | -- | | | -- |
| | | ----- | | | ----- | | | ----- |
| Income allocable to common shares plus assumed conversions | \$ | 18,135 | 29,224,605 | \$ | 0.62 | | \$ | 237 |
| | | ===== | ===== | | ===== | | | ===== |

| | | | | | |
|---|--|--|---------------|-----------|------------|
| (IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA) | | For the nine months ended September 30, 2003 | | | For the ni |
| | | Income | Shares | Per Share | Income |
| | | (Numerator) | (Denominator) | Amount | (Numerato |
| | | ----- | ----- | ----- | ----- |

BASIC EPS

| | | | | | |
|---------------------------------------|----|--------|------------|--------|----------|
| Net income from continuing operations | \$ | 37,434 | | \$1.32 | \$18,050 |
| Discontinued operations | | 25,748 | | 0.91 | -- |
| | | ----- | | ----- | ----- |
| Income allocable to common shares | \$ | 63,182 | 28,353,040 | \$2.23 | \$18,050 |
| | | ===== | | ===== | ===== |

EFFECT OF DILUTIVE SECURITIES

| | | | | | |
|-----------------------------|--|--|---------|--|-------|
| Options and deferred shares | | | 358,852 | | |
| Earnings contingency | | | -- | | ----- |

DILUTED EPS

| | | | | | |
|---|----|--------|------------|--------|----------|
| Net income from continuing operations | \$ | 37,434 | | \$1.30 | \$18,050 |
| Discontinued operations | | 25,748 | | 0.90 | -- |
| | | ----- | | ----- | ----- |
| Income allocable to common shares plus assumed conversions | \$ | 63,182 | 28,711,892 | \$2.20 | \$18,050 |
| | | ===== | ===== | ===== | ===== |

NOTE 13 - DISTRIBUTIONS

On October 16, 2003, the Board of Directors declared a distribution of \$0.45 for the three months ended September 30, 2003, to common shareholders of record on October 27, 2003. The payment date was November 7, 2003.

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NOTE 14 - NON-EMPLOYEE DIRECTORS' SHARE PLANS AND EMPLOYEE SHARE INCENTIVE PLANS

The Company accounts for both the non-employee director share plans and the employee share incentive plans (see Note 1 and Note 15 to the Company's 2002 Form 10-K) under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees." Accordingly, no compensation expense has been recognized for the options issued under the plans during the third quarter of 2003. The Company issued 7,000 options in the first quarter of 2003 and 30,000 options in the second quarter of 2003. The Company issued 30,000 options in the second quarter of 2002. The Company estimated the fair value of each option awarded using the Black Scholes option-pricing model with the following assumptions.

| | For the nine months ended September 30, | |
|--|---|-----------|
| | 2003 | 2002 |
| Risk-free interest rate | 3% | 4% |
| Dividend yield | 7.3% | 6.9% |
| Volatility | 14% | 21% |
| Expected option life | 7.5 years | 7.5 years |
| Weighted average fair value of options | \$ 0.77 | \$ 2.40 |

The following table illustrates the effect on net income and earnings per share if the compensation expense had been determined based on the fair value recognition provisions of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" as amended by Financial Accounting Standards No.148 "Accounting for Stock-Based Compensation-Transition and Disclosure."

| | For the nine months ended September 30, | |
|---|---|-----------|
| (000s) | 2003 | 2002 |
| Net income allocated to common shares, as reported | \$ 63,182 | \$ 18,050 |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects | (29) | (72) |
| Net income allocated to common shares, pro forma | 63,153 | \$ 17,978 |
| EARNINGS PER COMMON SHARE: | | |
| Basic - as reported | \$ 2.23 | \$ 0.73 |
| Basic - pro forma | \$ 2.23 | \$ 0.73 |
| Diluted - as reported | \$ 2.20 | \$ 0.71 |
| Diluted - pro forma | \$ 2.20 | \$ 0.71 |

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NOTE 15 - BUSINESS SEGMENT REPORTING

The Company has two reportable business segments: (1) an operating segment consisting of subsidiaries that primarily generate taxable fee income by providing tax credit equity syndication, loan servicing, loan origination and other related services and (2) an investing segment consisting primarily of subsidiaries holding investments producing tax-exempt interest income. The accounting policies of the segments are the same as those described in the summary of significant accounting policies in Note 1 to the Company's 2002 Form 10-K. A complete description of the Company's reporting segments is included in Note 18 to the Company's 2002 Form 10-K.

The following table reflects the results of the Company's business segments for the three and nine months ended September 30, 2003 and 2002.

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Municipal Mortgage & Equity, LLC
Segment Reporting for the three and nine months ended
September 30, 2003 and 2002
(in thousands) (unaudited)

| | For the three months ended September 30, | | |
|--|--|---------------|----------------|
| | Investing | Operating | Adjustments |
| | ----- | ----- | ----- |
| INCOME : | | | |
| Interest income | | | |
| Interest on bonds and residual interests in bond securitizations | \$ 15,361 | \$ 251 | \$ - |
| Interest on loans | 1,062 | 8,346 | - |
| Interest on short-term investments | 5,009 | 104 | (4,805) (1) |
| | ----- | ----- | ----- |
| Total interest income | 21,432 | 8,701 | (4,805) |
| | ----- | ----- | ----- |
| Fee income | | | |
| Syndication fees | - | 5,764 | - |
| Origination fees | - | 1,888 | (1,026) (2) |
| Loan servicing fees | - | 1,716 | - |
| Asset management and advisory fees | - | 3,191 | - |
| Other income | 790 | 2,792 | - |
| | ----- | ----- | ----- |
| Total fee income | 790 | 15,351 | (1,026) |
| | ----- | ----- | ----- |
| Net gain (loss) on sales | 4,334 | 3,954 | - |
| | ----- | ----- | ----- |
| TOTAL INCOME | 26,556 | 28,006 | (5,831) |
| | ----- | ----- | ----- |
| EXPENSES: | | | |
| Interest expense | 9,028 | 11,467 | (4,805) (1) |
| Salaries and benefits | 877 | 11,188 | - |
| General and administrative | 593 | 2,792 | - |
| Professional fees | 560 | 545 | - |
| Amortization of intangibles | - | 2,863 | - |

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| | | | |
|--|-----------|---------|------------|
| TOTAL EXPENSES | 11,058 | 28,855 | (4,805) |
| Net holding gains (losses) on derivatives | 3,498 | - | - |
| Impairments and valuation allowances related to investments | - | - | - |
| Net losses from equity investments in partnerships | - | (1,608) | - |
| NET INCOME BEFORE INCOME TAXES, INCOME ALLOCATED TO PREFERRED SHAREHOLDERS IN A SUBSIDIARY COMPANY AND DISCONTINUED OPERATIONS | 18,996 | (2,457) | (1,026) |
| Income tax benefit (expense) | - | 2,622 | - |
| NET INCOME BEFORE INCOME ALLOCATED TO PREFERRED SHAREHOLDERS IN A SUBSIDIARY COMPANY AND DISCONTINUED OPERATIONS | 18,996 | 165 | (1,026) |
| Income allocable to preferred shareholders in a subsidiary company | - | - | - |
| NET INCOME FROM CONTINUING OPERATIONS | 18,996 | 165 | (1,026) |
| Discontinued operations | - | - | - |
| NET INCOME (LOSS) | \$ 18,996 | \$ 165 | \$ (1,026) |

For the three months ended September

| | Investing | Operating | Adjustments |
|--|-----------|-----------|-------------|
| INCOME : | | | |
| Interest income | | | |
| Interest on bonds and residual interests in bond securitizations | \$ 15,051 | \$ 358 | \$ - |
| Interest on loans | 837 | 7,839 | - |
| Interest on short-term investments | 195 | 65 | - |
| Total interest income | 16,083 | 8,262 | - |
| Fee income | | | |
| Syndication fees | - | 767 | - |
| Origination fees | - | 2,206 | (192) (2) |
| Loan servicing fees | - | 1,544 | - |
| Asset management and advisory fees | - | 969 | - |
| Other income | 265 | 635 | - |
| Total fee income | 265 | 6,121 | (192) |
| Net gain (loss) on sales | 221 | 436 | - |
| TOTAL INCOME | 16,569 | 14,819 | (192) |
| EXPENSES: | | | |
| Interest expense | 1,907 | 6,864 | - |
| Salaries and benefits | 215 | 5,231 | - |
| General and administrative | 356 | 1,400 | - |
| Professional fees | 85 | 799 | - |
| Amortization of intangibles | - | 334 | - |
| TOTAL EXPENSES | 2,563 | 14,628 | - |

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| | | | |
|--|----------|----------|----------|
| Net holding gains (losses) on derivatives | (9,921) | - | - |
| Impairments and valuation allowances related to investments | - | - | - |
| Net losses from equity investments in partnerships | - | (1,488) | - |
| | ----- | ----- | ----- |
| NET INCOME BEFORE INCOME TAXES, INCOME ALLOCATED TO PREFERRED SHAREHOLDERS IN A SUBSIDIARY COMPANY AND DISCONTINUED OPERATIONS | 4,085 | (1,297) | (192) |
| Income tax benefit (expense) | - | 635 | - |
| | ----- | ----- | ----- |
| NET INCOME BEFORE INCOME ALLOCATED TO PREFERRED SHAREHOLDERS IN A SUBSIDIARY COMPANY AND DISCONTINUED OPERATIONS | 4,085 | (662) | (192) |
| Income allocable to preferred shareholders in a subsidiary company | (2,994) | - | - |
| | ----- | ----- | ----- |
| NET INCOME FROM CONTINUING OPERATIONS | 1,091 | (662) | (192) |
| Discontinued operations | - | - | - |
| | ----- | ----- | ----- |
| NET INCOME (LOSS) | \$ 1,091 | \$ (662) | \$ (192) |
| | ===== | ===== | ===== |

Notes:

- (1) Adjustments represent intercompany interest and expense that are eliminated in consolidation
- (2) Adjustments represent origination fees on purchased investments which are deferred and amortized into income over the life of the investment

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Municipal Mortgage & Equity, LLC
Segment Reporting for the three and nine months
ended September 30, 2003 and 2002
(in thousands) (unaudited)

| | For the nine months ended S | | |
|---|-----------------------------|-----------|--------|
| | Investing | Operating | Adjust |
| | ----- | ----- | ----- |
| INCOME: | | | |
| Interest income | | | |
| Interest on bonds and residual interests in bond securitizations | \$ 44,787 | \$ 739 | \$ |
| Interest on loans | 2,662 | 23,812 | |
| Interest on short-term investments | 7,624 | 240 | (7, |
| | ----- | ----- | ----- |
| Total interest income | 55,073 | 24,791 | (7, |
| | ----- | ----- | ----- |
| Fee income | | | |
| Syndication fees | - | 9,000 | |
| Origination fees | - | 5,758 | (1, |
| Loan servicing fees | - | 5,463 | |
| Asset management and advisory fees | - | 5,465 | |
| Other income | 3,975 | 5,113 | |
| | ----- | ----- | ----- |
| Total fee income | 3,975 | 30,799 | (1, |

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| | | | |
|--|-----------|---------|------------|
| Net gain (loss) on sales | 5,093 | 5,926 | |
| TOTAL INCOME | 64,141 | 61,516 | (9,000) |
| EXPENSES: | | | |
| Interest expense | 16,109 | 25,705 | (7,000) |
| Salaries and benefits | 2,323 | 24,379 | |
| General and administrative | 1,741 | 5,272 | |
| Professional fees | 1,497 | 1,474 | |
| Amortization of intangibles | - | 3,666 | |
| TOTAL EXPENSES | 21,670 | 60,496 | (7,000) |
| Net holding gains (losses) on derivatives | 3,922 | - | |
| Impairments and valuation allowances related to investments | (1,097) | (47) | |
| Net losses from equity investments in partnerships | - | (3,961) | |
| NET INCOME BEFORE INCOME TAXES, INCOME ALLOCATED TO PREFERRED SHAREHOLDERS IN A SUBSIDIARY COMPANY AND DISCONTINUED OPERATIONS | 45,296 | (2,988) | (1,000) |
| Income tax benefit (expense) | - | 3,094 | |
| NET INCOME BEFORE INCOME ALLOCATED TO PREFERRED SHAREHOLDERS IN A SUBSIDIARY COMPANY AND DISCONTINUED OPERATIONS | 45,296 | 106 | (1,000) |
| Income allocable to preferred shareholders in a subsidiary company | (5,989) | - | |
| NET INCOME FROM CONTINUING OPERATIONS | 39,307 | 106 | (1,000) |
| Discontinued operations | 25,748 | - | |
| NET INCOME (LOSS) | \$ 65,055 | \$ 106 | \$ (1,000) |

For the nine months ended September 30, 2011

| | Investing | Operating | Adjusting |
|--|-----------|-----------|-----------|
| INCOME: | | | |
| Interest income | | | |
| Interest on bonds and residual interests in bond securitizations | \$ 43,753 | \$ 2,217 | \$ - |
| Interest on loans | 2,517 | 23,183 | |
| Interest on short-term investments | 830 | 161 | |
| Total interest income | 47,100 | 25,561 | |
| Fee income | | | |
| Syndication fees | - | 4,765 | |
| Origination fees | - | 6,719 | (2,111) |
| Loan servicing fees | - | 5,112 | |
| Asset management and advisory fees | - | 2,876 | |
| Other income | 734 | 2,570 | |
| Total fee income | 734 | 22,042 | (2,111) |
| Net gain (loss) on sales | (1,897) | 5,423 | |

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| | | | |
|--|-----------|----------|-----------|
| TOTAL INCOME | 45,937 | 53,026 | (2,11) |
| EXPENSES: | | | |
| Interest expense | 6,421 | 19,809 | |
| Salaries and benefits | 1,833 | 14,370 | |
| General and administrative | 1,110 | 4,069 | |
| Professional fees | 460 | 3,028 | |
| Amortization of intangibles | - | 985 | |
| TOTAL EXPENSES | 9,824 | 42,261 | |
| Net holding gains (losses) on derivatives | (14,530) | - | |
| Impairments and valuation allowances related to investments | (110) | - | |
| Net losses from equity investments in partnerships | - | (1,717) | |
| NET INCOME BEFORE INCOME TAXES, INCOME ALLOCATED TO PREFERRED SHAREHOLDERS IN A SUBSIDIARY COMPANY AND DISCONTINUED OPERATIONS | 21,473 | 9,048 | (2,11) |
| Income tax benefit (expense) | - | (1,224) | |
| NET INCOME BEFORE INCOME ALLOCATED TO PREFERRED SHAREHOLDERS IN A SUBSIDIARY COMPANY AND DISCONTINUED OPERATIONS | 21,473 | 7,824 | (2,11) |
| Income allocable to preferred shareholders in a subsidiary company | (8,983) | - | |
| NET INCOME FROM CONTINUING OPERATIONS | 12,490 | 7,824 | (2,11) |
| Discontinued operations | - | - | |
| NET INCOME (LOSS) | \$ 12,490 | \$ 7,824 | \$ (2,11) |

Notes:

- (1) Adjustments represent intercompany interest and expense that are eliminated in consolidation
- (2) Adjustments represent origination fees on purchased investments which are deferred and amortized into income over the life of the investment

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NOTE 16 - SUBSEQUENT EVENTS

In October 2003, the Company sold to the public 3.6 million common shares (including the entire underwriters' overallotment option) at a price of \$24.40 per share. The majority of the \$83.6 million net proceeds was used to repay debt incurred in connection with the acquisition of HCI.

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

GENERAL BUSINESS

The Company provides debt and equity financing to developers of

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multifamily housing. The Company invests in tax-exempt bonds, or interests in bonds, issued by state and local governments or their agencies or authorities to finance multifamily housing developments. Although these tax-exempt bonds are not general obligations of state and local governments, or the agencies or authorities that issue the bonds, the bonds are secured by the rents and other revenues of the housing developments financed by the bonds and by the underlying real estate. Interest income derived from the majority of these bond investments is exempt income for federal income tax purposes.

The Company is also a mortgage banker. Mortgage banking activities include the origination, investment in and servicing of investments in multifamily housing, both for its own account and on behalf of third parties. These investments generate taxable income.

The Company also acquires and sells interests in partnerships that provide low-income housing tax credits for investors. The Company earns syndication fees on the placement of these interests with investors. The Company also earns guarantee fees for providing guarantees on certain tax credit funds and asset management fees for managing the low-income housing tax credit funds it has syndicated.

The Company also invests in other housing-related debt and equity investments, including equity investments in income-producing real estate operating partnerships and tax-exempt bonds, or interests in bonds, secured by student housing or assisted living developments, and tax-exempt community development bonds, typically secured by special taxes imposed on single-family or other community development districts or by assessments imposed on the residents or other owners of lots in those developments.

Acquisition of Housing and Community Investing business of Lend Lease Real Estate Investments

On July 1, 2003, the Company acquired the Housing and Community Investing ("HCI") business of Lend Lease Real Estate Investments for \$102 million in cash. The acquisition was financed by a \$120 million secured term credit facility provided by a syndicate of banks led by the Royal Bank of Canada. HCI is a syndicator of low income housing tax credit equity investments. The HCI business is owned by MMA Financial TC Corp. ("TC CORP"), a wholly owned subsidiary of the Company, and the Company's results for the third quarter of 2003 reflect a full quarter of activity from TC Corp. In connection with this acquisition, the Company's operating subsidiary, MuniMae Midland, LLC, has been renamed MMA Financial, LLC.

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LIQUIDITY AND CAPITAL RESOURCES

The Company's sources of capital to fund its tax-exempt bond lending activities include proceeds from equity offerings, securitizations, and lines of credit. The Company's sources of capital to fund its mortgage banking activities include (1) warehousing facilities and short-term lines of credit with commercial banks and pension funds, (2) debt and equity financings, either through the Midland Affordable Housing Group Trust or the Midland Multifamily Equity REIT ("MMER"), and (3) working capital.

The Company relies on the regular availability of capital from pension funds, certain government sponsored entities ("GSES"), equity offerings, bank lines of credit and securitization transactions to finance its growth. The Company expects to meet its cash needs in the short-term, which consist primarily of funding new investments, paying distributions to shareholders and funding mortgage banking activities, from equity offering proceeds, cash on hand

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and bank lines of credit. The Company expects to have access to adequate capital to meet its 2003 production targets. To continue to grow these activities, the Company will need to increase its access to capital in future years. Therefore, the Company continues to expand its line of credit capacity and to complete equity offerings as discussed below.

For the three months ended September 30, 2003, the Company structured \$101.0 million in tax-exempt bond transactions. This total counts construction and permanent financing components separately, even though they relate to the same real estate project, for consistency with tracking of the Company's taxable lending, where construction and permanent loans are legally distinct loans. In addition, the Company originated \$48.0 million of construction loans, \$54.4 million of permanent loans and \$17.8 million of supplemental loans, all of which generate taxable interest income. The Company also closed \$145.1 million for investment in syndicated tax credit equity funds.

Activity for the third quarter of 2003 related to liquidity and capital resources is discussed below. For a complete discussion of liquidity and capital resources, see the Company's 2002 Form 10-K.

Lines of Credit

During the third quarter of 2003, the Company obtained a \$120 million secured term credit facility provided by a syndicate of banks led by the Royal Bank of Canada. This facility was used to finance the acquisition of HCI. In addition, the Company expanded the capacity of a general bank line of credit used to warehouse real estate operating partnerships before the partnerships are placed into tax credit equity funds from \$30 million to \$75 million.

Equity Offerings

In October 2003, the Company sold to the public 3.6 million common shares (including the entire underwriters' overallotment option) at a price of \$24.40 per share. The majority of the \$83.6 million in net proceeds of this offering was used to repay debt incurred in connection with the acquisition of HCI.

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Leverage

As a result of the acquisition of HCI and the adoption of new accounting standards, the Company's on-balance sheet liabilities increased significantly in the third quarter. The GAAP rules that caused this increase include Statement of Financial Accounting Standards No. 66, "Accounting for Sales of Real Estate" ("SFAS 66"), and Statement of Financial Accounting Standards No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity" ("SFAS 150"). SFAS 66 requires consolidation of certain transactions and financings with respect to which the Company believes it has minimal risk of loss, and SFAS 150 requires the reclassification to debt of certain securities which were previously classified as preferred equity interests in a subsidiary. Management believes that these changes may cause GAAP-derived measures of leverage to provide a less accurate picture of the Company's actual economic leverage and may over time tend to exaggerate the Company's leverage-related risks. In addition, a new standard, Financial Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46"), may also have a similar effect on leverage. See New Accounting Pronouncements for further discussion of FIN 46.

Consequently, the Company has prepared the following table in an effort to enable investors to gain a better understanding of the various components of

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the Company's published leverage measure. The table provides an overview, organized according to major categories of invested assets or product types, of the Company's assets and liabilities as of September 30, 2003. The Company believes this presentation provides helpful detail on the components of the Company's leverage and how the Company's assets and liabilities relate to those major categories. The table also provides data on the Company's off-balance sheet bond securitizations as of September 30, 2003 (see column I), in order to permit comparison of the Company's leverage based on the GAAP balance sheet alone to leverage inclusive of those off-balance sheet items. Readers are cautioned that (1) this table does not reflect formal operating units or business segments within the Company, (2) shareholder's equity for each of columns A through G was calculated by taking assets minus liabilities for each column, and the related columnar shareholder equity figures should not be construed as representing the actual or notional equity supporting the invested assets or product type represented by a given column, (3) various items grouped in column E (Other) relate to other columns but have been aggregated in column E for ease of presentation and simplicity (e.g., cash is not allocated among the various columns), (4) the preferred equity interest in MuniMae TE Bond Subsidiary, LLC has been presented in a separate column F to highlight subsidiary preferred shares reclassified to debt as of July 1, 2003 according to SFAS 150 and (5) this table is not prepared in accordance with GAAP and is not intended to replace or approximate GAAP.

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MUNICIPAL MORTGAGE & EQUITY, LLC
ANALYSIS OF CONSOLIDATED BALANCE SHEET COMPONENTS
9/30/2003
(IN THOUSANDS, EXCEPT SHARE DATA)

(UNAUDITED)

| | (A) | |
|--|---|---------|
| | Bond Securitizations and Derivatives (1) | Taxable |
| | ----- | ----- |
| ASSETS | | |
| Investment in tax-exempt bonds, net | \$ 792,332 | \$ |
| Loans receivable, net | 26,426 | |
| Loans receivable held for sale | | |
| Investments in partnerships | | |
| Residual interests in bond securitizations | 11,944 | |
| Investment in derivative financial instruments | 2,755 | |
| Cash and cash equivalents | | |
| Interest receivable | | |
| Restricted assets | 12,023 | |

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| | | | |
|--|------------|-----------------|-------|
| Other assets | | | |
| Mortgage servicing rights, net | | | |
| Goodwill and other intangibles (7) | | | |
| | ----- | | ----- |
| TOTAL ASSETS | \$ 845,480 | | \$ |
| | ===== | | ===== |
| LIABILITIES | | | |
| Notes payable | \$ 39,129 | | \$ |
| Short-term debt | 191,835 | | |
| Long-term debt | 155,448 | | |
| Preferred shares subject to mandatory redemption | | | |
| Tax credit syndication guarantee liability | | | |
| Residual interests in bond securitizations | 1,925 | | |
| Investment in derivative financial instruments | 17,879 | | |
| Accounts payable and accrued expenses | | | |
| Interest payable | | | |
| Unearned revenue and other liabilities | | | |
| | ----- | | ----- |
| TOTAL LIABILITIES | 406,216 | | |
| | ----- | | ----- |
| Liabilities / Assets | | 48% (9) | |
| Percentage of liabilities - balance sheet 9/30/03 | | 30% | |
| Percentage of liabilities - adjusted balance sheet 9/30/03 | | 25% | |
| EXCESS OF ASSETS OVER LIABILITIES (8) | \$ 439,264 | | \$ |
| | ===== | | ===== |
| | | (D) | (E) |
| | | CAPREIT Equity | Prefe |
| | | Investments (4) | TE |
| | | ----- | ----- |
| ASSETS | | | |
| Investment in tax-exempt bonds, net | \$ - | \$ - | \$ |
| Loans receivable, net | 2,522 | - | |
| Loans receivable held for sale | | - | |
| Investments in partnerships | 60,727 | (3) | |

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| | | | | |
|--|----|---------|-----------|-------|
| Residual interests in bond securitizations | | | - | |
| Investment in derivative financial instruments | | | - | |
| Cash and cash equivalents | | | 46,008 | |
| Interest receivable | | | 16,260 | |
| Restricted assets | | 48,622 | - | |
| Other assets | | | 40,997 | |
| Mortgage servicing rights, net | | | - | |
| Goodwill and other intangibles (7) | | | 1,897 | |
| | | ----- | ----- | ----- |
| TOTAL ASSETS | \$ | 111,871 | \$105,159 | \$ |
| | | ===== | ===== | ===== |
| | | | | |
| LIABILITIES | | | | |
| Notes payable | \$ | - | \$ - | \$ |
| Short-term debt | | | - | |
| Long-term debt | | | - | |
| Preferred shares subject to mandatory redemption | | | - | |
| Tax credit syndication guarantee liability | | | - | |
| Residual interests in bond securitizations | | | - | |
| Investment in derivative financial instruments | | | - | |
| Accounts payable and accrued expenses | | | 12,744 | |
| Interest payable | | | 8,657 | |
| Unearned revenue and other liabilities | | | 31,515 | |
| | | ----- | ----- | ----- |
| TOTAL LIABILITIES | | - | 52,916 | |
| | | ----- | ----- | ----- |
| | | | | |
| Liabilities / Assets | | 0% | 50% | |
| Percentage of liabilities - balance sheet 9/30/03 | | 0% | 4% | |
| Percentage of liabilities - adjusted balance sheet 9/30/03 | | 0% | 3% | |
| EXCESS OF ASSETS OVER LIABILITIES (8) | \$ | 111,871 | \$ 52,243 | \$ |
| | | ===== | ===== | ===== |

(H)

(I)

Balance Sheet

Off Balan

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| | September 30, 2003 ----- | Bond Secu ----- |
|---|-----------------------------|--------------------|
| ASSETS | | |
| Investment in tax-exempt bonds, net | \$ 792,332 | \$ |
| Loans receivable, net | 472,620 | |
| Loans receivable held for sale | 9,118 | |
| Investments in partnerships | 233,032 | |
| Residual interests in bond securitizations | 11,944 | |
| Investment in derivative financial instruments | 2,755 | |
| Cash and cash equivalents | 46,008 | |
| Interest receivable | 16,260 | |
| Restricted assets | 115,097 | |
| Other assets | 78,467 | |
| Mortgage servicing rights, net | 10,841 | |
| Goodwill and other intangibles (7) | 131,422 | |
| | ----- | ----- |
| TOTAL ASSETS | \$ 1,919,896 ===== | \$ 2 ===== |
| LIABILITIES | | |
| Notes payable | \$ 609,506 | \$ |
| Short-term debt | 191,835 | 1 |
| Long-term debt | 155,448 | 1 |
| Preferred shares subject to mandatory redemption | 168,000 | |
| Tax credit syndication guarantee liability | 149,305 | |
| Residual interests in bond securitizations | 1,925 | |
| Investment in derivative financial instruments | 17,879 | |
| Accounts payable and accrued expenses | 12,792 | |
| Interest payable | 8,657 | |
| Unearned revenue and other liabilities | 37,897 | |
| | ----- | ----- |
| TOTAL LIABILITIES | 1,353,244 ----- | 2 ----- |
| Liabilities / Assets | 70.5% | |
| Percentage of liabilities - balance sheet 9/30/03 | 100% | |

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| | | |
|--|------------|-------|
| Percentage of liabilities - adjusted balance sheet 9/30/03 | N/A | |
| EXCESS OF ASSETS OVER LIABILITIES (8) | \$ 566,652 | \$ |
| | ===== | ===== |

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NOTES

- (1) Bond securitizations and derivatives includes the Company's investments in tax-exempt bonds, bond related investments and derivatives and the related on-balance sheet debt and cash collateral.
- (2) Taxable lending includes the Company's construction and permanent loans and the related borrowings from the Midland Affordable Housing Group Trust, pension funds and lines of credit.
- (3) Tax credit operations includes the Company's investment in properties and advances to tax credit equity funds and the related borrowings under lines of credit. This column also includes \$120 million of borrowings under a line of credit at 9/30/03 used to finance the July 2003 acquisition of HCI's tax credit operations.
- (4) CAPREIT equity investments includes the taxable equity investments in the CAPREIT joint ventures and the related cash collateral.
- (5) Due to Statement of Financial Accounting Standards No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity," the preferred shares issued by MuniMae TE Bond Subsidiary, LLC have been reclassified as debt.
- (6) Tax credit guaranteed funds includes assets and liabilities associated with funds where the Company has provided investors a guarantee or has continuing involvement with the assets of the funds. All of these assets and liabilities relate to interests in tax credit equity syndications acquired as of July 1, 2003 from Lend Lease.
- (7) Goodwill of \$33.6 million related to the 1999 purchase of the Midland Companies has been allocated equally between taxable lending and tax credit operations. The balance of the intangibles and goodwill relates to the July 2003 acquisition of the HCI tax credit operations.
- (8) Excess of assets over liabilities was calculated by taking assets minus liabilities for each column, and therefore these amounts may not accurately represent the actual or notional amount of equity attributable to each column.
- (9) Including the assets and liabilities from off balance sheet bond securitizations the percentage would be 62%.

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Factors that Could Affect Future Results

The Company's 2002 Form 10-K contains a detailed description of the Company's factors that could affect future results. There has been no material change since December 31, 2002 to the information related to factors that could affect future results.

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The Company's business prospects are directly impacted by governmental tax policies, which affect demand for the Company's debt and equity financing products as well as investor demand for the Company's securities and the tax credit equity funds which the Company syndicates. A reduction in the scale of, or the tax benefits provided by, governmental programs supporting the development of affordable and other housing-related investments originated by the Company, or the elimination of these programs altogether, would significantly reduce the Company's opportunities to originate, structure and invest in housing-related financings and would consequently have a significant adverse impact on the Company's net income and cash available for distribution ("CAD").

The Company's July 2003 acquisition of HCI will generate significantly higher syndication fee and asset management revenues from our tax credit equity business. Because the tax credit equity syndication business is seasonal, with the bulk of syndications closing in the fourth and second quarters of each calendar year, the Company expects to experience greater volatility in its quarterly CAD earnings than it experienced prior to the acquisition. As a result of the seasonality in our production volumes, the Company expects to have higher income in the second and fourth quarters of each fiscal year than in the first and third quarters, while routine operating expenses, with the exception of bonus accruals related to production levels, are expected to be less susceptible to quarterly fluctuations.

Contractual Obligations

Material activity for the third quarter of 2003 related to contractual obligations is discussed below. For a complete discussion of contractual obligations, see the Company's 2002 Form 10-K.

As part of the acquisition of HCI, the Company became obligated under various operating leases for office space, storage space, office services and computer services. The leases expire through July 2007. The annual rent under these leases is \$3.7 million.

Guarantees and Off-Balance Sheet Arrangements

The Company's 2002 Form 10-K contains a summary of the Company's guarantees and off-balance sheet arrangements. During the third quarter of 2003, the Company entered a guarantee agreement related to the \$120 million line of credit used to finance the acquisition of HCI. The Company has guaranteed the payment of outstanding principal and interest on this facility. In addition, the Company assumed or provided various guarantees in connection with the purchase of HCI. See Note 8 for a table that summarizes the Company's guarantees by type as of September 30, 2003.

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Dividend Policy and Cash Available for Distribution

The Company focuses on maximizing shareholder value through increases in cash distributions to shareholders. The Company uses CAD as a primary measure of its ability to pay distributions. The Company believes CAD is the most relevant measure of its ability to pay distributions because it is a measure of current earnings. The Company uses this measure of current earnings as a basis for declaring its quarterly distributions.

CAD differs from net income because of variations between GAAP income and actual cash received. There are four primary differences between CAD and GAAP income. The first is the treatment of several types of fees (including

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origination, syndication, guarantee and asset management fees), which for CAD purposes are recognized as income when received or earned but for GAAP purposes may be amortized into income over time or deferred until certain events occur. The second difference is that the non-cash gain and loss recognized for GAAP associated with valuations, sales of investments and capitalization and amortization of mortgage servicing rights are not included in the calculation of CAD. The third difference is the treatment of the Company's investments in partnerships. For GAAP, the Company records its allocable share of the income (loss) from the partnership as income, while for CAD reporting the Company records the cash distributions it receives from the partnership as income. The fourth difference is the treatment of tax credit equity funds in which the Company provides a guarantee or otherwise has continuing involvement in the underlying assets of the fund. GAAP accounting requires that the Company record income (loss) from these funds. This non-cash item is not reflected in CAD.

The Company's current policy is to distribute to common shareholders at least 80% of its annual CAD to common shares. The table below shows the Company's CAD available to common shares, CAD per common share, dividend per common share and payout ratio for the three and nine months ended September 30, 2003 and 2002.

| | For the three months ended September 30, | | For the n |
|---------------------------------------|--|-----------|-----------|
| | 2003 | 2002 | 2003 |
| CAD available to common shares (000s) | \$ 15,291 | \$ 12,881 | \$ 44 |
| CAD per common share (1) | 0.53 | 0.51 | |
| Dividend per common share | 0.4500 | 0.4400 | 1. |
| Payout ratio (2) | 95.8% | 86.6% | |

(1) CAD per common share is calculated based on the number of shares outstanding at the end of each fiscal quarter.

(2) The payout ratio calculation for the three and nine months ended September 30, 2003 is based on 32,540,412 common shares outstanding to reflect the 3,622,500 shares issued in October 2003 that will also receive the third quarter distribution.

The following table reconciles the Company's GAAP net income to CAD for the three and nine months ended September 30, 2003 and 2002.

| | FOR THE THREE MONTHS ENDED SEPTEMBER 30, | |
|--|---|---------|
| | 2003 | 2002 |
| NET INCOME ALLOCATED TO COMMON SHARES - GAAP BASIS | \$ 18,135 | \$ 23 |
| Conversion to Cash Available for Distribution: | | |
| (1) Mark to market adjustments | \$ (3,498) | \$ 9,92 |
| (2) Equity investments | 1,995 | 3,24 |

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| | | |
|---|-----------|----------|
| (3) Net gain on sales | (577) | (45) |
| (3) Amortization of capitalized mortgage servicing fees | 390 | 33 |
| (3) Amortization of asset management contracts | 2,422 | |
| (4) Origination fees, syndication fees and other income, net | 2,675 | 5 |
| (5) Valuation allowances and other-than-temporary impairments | - | |
| (6) Deferred tax expense | (2,622) | (46) |
| (7) Discontinued operations | - | |
| (7) Interest income | - | |
| (8) Fund income | (3,629) | |
| | ----- | ----- |
| CASH AVAILABLE FOR DISTRIBUTION (CAD) | \$ 15,291 | \$ 12,88 |
| | ===== | ===== |

Notes

(1) For GAAP reporting, the Company records the non-cash change in fair value of its investment in interest rate swaps and other derivative financial instruments through net income. These non-cash gains and losses are not included in the Company's calculation of CAD.

(2) For GAAP reporting, the Company accounts for various investments in partnerships using the equity accounting method. As a result, the Company's allocable share of the income or loss from the partnerships is reported in income (losses) from equity investments in partnerships. The income from these partnerships includes depreciation expense and changes in the fair value of investments in derivatives. For GAAP reporting, distributions are treated as a return of capital. For CAD reporting, the Company records the cash distributions it receives from the partnerships as other income. In addition, a portion of the income or loss from partnerships is reduced by a minority interest for both GAAP and CAD.

(3) For GAAP reporting, the Company recognizes non-cash gains and losses and amortization of intangible assets, including (a) non-cash gains and losses associated with the sale of assets or capitalization of mortgage servicing rights; (b) amortization of mortgage servicing rights over the estimated life of the serviced loans; and (c) amortization of asset management contracts recorded in connection with a July 2003 acquisition. These non-cash items are not included in CAD.

(4) This adjustment reflects the net difference, for the relevant period, between fees reflected in income when received for CAD and the recognition of fees for GAAP. This line item reflects several types of income:

(a) Origination fees and certain other income amounts, which are recognized as income when received for CAD purposes, but for GAAP reporting are amortized over the life of the associated investment.

(b) Syndication fees, which are recognized as income when earned for CAD purposes, but for GAAP reporting a portion of the fee may be deferred until investors have paid in greater than 20% of their total capital contributions to the tax credit funds.

(c) Guarantee fees, which are recognized as income when received for CAD purposes, but for GAAP reporting are recorded into income over the guarantee period.

(d) Asset management fees, which are recognized as income when earned and collectible for CAD purposes, but for GAAP purposes are applied first to relieve accounts receivable recorded in conjunction with the July 2003 acquisition, and second as income consistent with the CAD revenue recognition.

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(5) For GAAP reporting, the Company records valuation allowances and other-than-temporary impairments on its investments in loans, bonds and other bond-related investments. Such non-cash charges do not affect the cash flow generated from the operation of the underlying properties, distributions to shareholders, or the tax-exempt status of the income of the financial obligation under the bonds. Therefore, these items are not included in the calculation of CAD.

(6) For GAAP reporting, the Company's income tax expense contains both a current and a deferred component. Only the Company's current income tax expense is reflected in CAD.

(7) For GAAP reporting, the Company recognized a gain upon the sale of a property. This gain was required to be classified as discontinued operations because the Company owned the property prior to the sale. For CAD reporting, the gain was significantly less due to recording a portion of the proceeds as interest income. In addition, the carrying value of the tax-exempt bond associated with the property was significantly more for CAD due to an impairment previously recognized for GAAP.

(8) For those of the Company's tax credit equity syndication funds in which the Company provides a guarantee or otherwise has continuing involvement in the underlying assets of the fund, GAAP accounting requires the Company to record the net income (loss) from the fund. This non-cash item is not reflected in CAD.

The calculation of CAD is the basis for the determination of the Company's quarterly distributions to common shares, is used by securities analysts and is presented as a supplemental measure of the Company's performance. The calculation is not approved by the Securities and Exchange Commission nor is it required by GAAP and should not be considered as an alternative to net income as an indicator of the Company's operating performance or as an alternative to cash flows as a measure of liquidity. The Company believes that CAD provides relevant information about its operations and is necessary, along with net income, for understanding its operating results.

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RESULTS OF OPERATIONS AND CRITICAL ACCOUNTING ESTIMATES

Critical Accounting Policies and Estimates

The Company's 2002 Form 10-K contains a detailed description of the Company's critical accounting policies and estimates. Except as disclosed below, there has been no material change to the information related to critical accounting policies and estimates since December 31, 2002.

As the part of the acquisition of HCI, the Company is providing guarantees to Lend Lease related to certain tax credit equity syndication funds where Lend Lease is providing a guarantee to investors or a third party. As a result of the guarantees, the Company is considered to have continuing involvement with the assets of the tax credit equity funds and to have effective control over the assets in the funds. Therefore, the Company accounts for its involvement in these funds under the financing method. Under the financing method, the Company includes the assets of the funds, consisting primarily of restricted cash and investments in partnerships, in the Company's consolidated balance sheet. In addition, the capital contributions of investors in these funds are reported as a liability on the Company's consolidated balance sheet. The income and expenses from these tax credit equity funds is reported in the appropriate line items of the Company's consolidated statements of income. The liability for the investors' capital contributions is relieved as the guarantees

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expire or are amortized into income over the life of the guarantee and reported in other income in the Company's consolidated statements of income.

New Accounting Pronouncements

In May 2003, the Financial Accounting Standards Board approved FAS 150. FAS 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify financial instruments with certain debt-like characteristics as liabilities. The scope of FAS 150 includes financial instruments issued in the form of mandatorily redeemable shares, which embody an unconditional obligation requiring the issuer to redeem the shares by transferring assets at a specified date. Management has determined that the Company's preferred shareholders' equity in a subsidiary company falls within the scope of FAS 150. Therefore for the third quarter of 2003, the Company has reclassified the liquidation preference value of its preferred shareholders' equity of \$168.0 million to a separate line in the liability section of the consolidated balance sheets. In addition, offering costs of \$7.5 million related to these preferred shares have been reclassified to other assets and are being amortized through the mandatory tender dates of the preferred shares. Amounts previously classified as distributions to preferred shareholders are now recorded as interest expense.

In January 2003, the Financial Accounting Standards Board approved Interpretation No. 46, "Consolidation of Variable Interest Entities". FIN 46 requires the consolidation of a company's equity investment in a variable interest entity ("VIE") if the company is the primary beneficiary of the VIE and if risks are not effectively dispersed among the owners of the VIE. The company is considered to be the primary beneficiary of the VIE if the company absorbs the majority of the losses of the VIE. FIN 46 is effective for VIEs created after January 31, 2003. For any VIE in which the Company held an interest that it acquired before February 1, 2003, FIN 46 was effective for the first

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reporting period ending after June 15, 2003. The Financial Accounting Standards Board has extended the effective date until the first reporting period ending after December 15, 2003 and the Company has elected to defer adoption of FIN 46 until that time. The Company is currently reviewing the impact of FIN 46 on the tax credit equity syndication funds that a wholly owned subsidiary of the Company sponsors and asset manages, as well as investments accounted for under the equity method of accounting. The Company will continue to review new investments in order to determine if they should be accounted for in accordance with FIN 46.

Net Interest Income

| (000s) | For the three months ended September 30, | | | | For the nine |
|--|--|---------|-----------|--------|--------------|
| | 2003 | % | 2002 | % | 2003 |
| Interest on bonds and residual interests in bond securitizations | \$ 15,612 | 162.0% | \$ 15,409 | 98.9% | \$ 45,526 |
| Interest on loans | 9,408 | 97.6% | 8,676 | 55.7% | 26,474 |
| Interest on short-term investments | 308 | 3.2% | 260 | 1.7% | 832 |
| Total interest income | 25,328 | | 24,345 | | 72,832 |
| Interest expense | (15,690) | -162.8% | (8,771) | -56.3% | (34,782) |

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| | | | | | |
|---------------------|----------|--------|-----------|--------|-----------|
| Net interest income | \$ 9,638 | 100.0% | \$ 15,574 | 100.0% | \$ 38,050 |
|---------------------|----------|--------|-----------|--------|-----------|

Net interest income for the quarter ended September 30, 2003 decreased \$5.9 million compared to the same period last year due primarily to: (1) \$3.0 million increase in interest expense related to the reclassification of the preferred shares distribution as of July 1, 2003; (2) a \$2.5 million increase in interest expense due to an increase in financing costs related to securitizations and larger average notes payable balances outstanding during the quarter; (3) \$1.4 million in interest expense related to a line of credit used to finance the acquisition of HCI; and (4) a \$0.9 million increase in the accrual of interest on bonds, residual interests in bond securitizations and loans.

Net interest income for the nine months ended September 30, 2003 decreased \$8.4 million compared to the same period last year due primarily to: (1) a \$4.1 million increase in interest expense due to an increase in financing costs related to securitizations and larger average notes payable balances outstanding during the 2003 period; (2) a \$3.0 million increase in interest expense related to the reclassification of the preferred shares distribution; (3) \$1.4 million in interest expense related to a line of credit used to finance the acquisition of HCI; and (4) a \$0.3 million decrease in the accrual of interest on bonds, residual interests in bond securitizations and loans.

Fee Income

| (000s) | For the three months ended September 30, | | | | For the nine |
|------------------------------------|--|--------|----------|--------|--------------|
| | 2003 | % | 2002 | % | 2003 |
| Syndication fees | \$ 5,764 | 38.1% | \$ 767 | 12.4% | \$ 9,000 |
| Origination fees | 862 | 5.7% | 2,014 | 32.5% | 3,779 |
| Loan servicing fees | 1,716 | 11.4% | 1,544 | 24.9% | 5,463 |
| Asset management and advisory fees | 3,191 | 21.1% | 969 | 15.7% | 5,465 |
| Other income | 3,582 | 23.7% | 900 | 14.5% | 9,088 |
| Total fee income | \$ 15,115 | 100.0% | \$ 6,194 | 100.0% | \$ 32,795 |

Total fee income for the quarter ended September 30, 2003 increased \$8.9 million compared to the same period last year due primarily to: (1) a \$5.0 million increase in syndication fees due to an increase in the volume of syndications closed generated by HCI; (2) a \$2.7 million increase in other income due primarily to: (i) \$1.4 million in guarantee, contingent general partner and investment valuation services fees from HCI; and (ii) \$1.1 million in other income from the consolidated guaranteed tax credit funds; (3) a \$2.2 million increase in asset management and advisory fees

primarily due to asset management fees from HCI; and (4) a \$1.2 million decrease in origination fees primarily due to a decrease in the volume of permanent loans and conventional equity deals closed.

Total fee income for the nine months ended September 30, 2003 increased

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\$12.1 million compared to the same period last year due primarily to: (1) a \$5.8 million increase in other income due primarily to: (i) \$1.7 million in prepayment fees collected from the early payment of tax-exempt bond investments; (ii) \$1.6 million in fees collected on a conventional equity deal; (iii) \$1.4 million in guarantee, contingent general partner and investment valuation services fees from HCI; (iv) \$1.1 million in other income from the consolidated guaranteed tax credit funds; (v) \$0.8 million collected as the result of a collateral release after the sale of a property; (vi) \$0.3 million of amortization of a guarantee fee received in the fourth quarter of 2002; (vii) \$0.3 million of income collected on a new put; and (viii) a \$1.4 million decrease in commission income; (2) a \$4.2 million increase in syndication fees due primarily to: (i) a \$5.0 million increase in syndication fees due to an increase in the volume of syndications closed generated by HCI; and (ii) a decrease due to taking \$0.5 million in organizational and offering cost reimbursements related to closed syndicated tax credit equity funds into income during the first quarter of 2002, whereas no such fees were recognized during 2003; (3) a \$2.6 million increase in asset management and advisory fees primarily due to asset management fees from HCI and an increase in tax credit equity and MMER assets under management; and (4) a \$0.8 million decrease in origination fees due to a decrease in the volume of permanent loans and conventional equity deals closed.

Net Gain on Sales

| (000s) | For the three months ended September 30, | | | | For the nine |
|---|--|---------------|---------------|---------------|------------------|
| | 2003 | % | 2002 | % | 2003 |
| Gain recorded for capitalized mortgage servicing rights | \$ 337 | 4.1% | \$ 450 | 68.5% | \$ 938 |
| Sales and payoffs of investments | 3,480 | 42.0% | 207 | 31.5% | 4,592 |
| Swap terminations | - | 0.0% | - | - | 742 |
| Sale of investments in partnerships | - | 0.0% | - | - | 276 |
| Guaranteed tax credit equity funds | 4,471 | 53.9% | - | - | 4,471 |
| Total net gain on sales | \$ 8,288 | 100.0% | \$ 657 | 100.0% | \$ 11,019 |

Net gain on sales for the quarter ended September 30, 2003 increased \$7.6 million compared to the same period last year due primarily to: (1) \$4.5 million in gain on sales from the consolidated guaranteed tax credit equity funds; (2) a \$3.5 million increase in gain on the sales and payoff of investments due to the increase in premiums on the delivery of loans to HUD and the sale of two tax-exempt bond investments; (3) a \$0.2 million decrease due to a gain on the sale of U.S. treasuries in the third quarter of 2002; and (4) a \$0.1 million decrease in the gain recorded for capitalized mortgage servicing rights due to a decrease in the dollar amount of permanent loans sold.

Net gain on sales for the nine months ended September 30, 2003 decreased \$7.5 million compared to the same period last year due primarily to: (1) \$4.5 million in gain on sales from the consolidated guaranteed tax credit equity funds; (2) a \$3.4 million increase in gain on the sales and payoff of investments due to the increase in premiums on the delivery of loans to HUD and the sale of tax-exempt bond investments; (3) a \$0.7 million net gain recorded on the termination of interest rate swaps; and (4) a \$1.2 million decrease in the gain recorded for capitalized mortgage servicing rights due to a decrease in the dollar amount of permanent loans sold.

Operating Expenses and Amortization

| (000s) | For the three months ended September 30, | | | | For the nine |
|-----------------------------|--|--------|----------|--------|--------------|
| | 2003 | % | 2002 | % | 2003 |
| Salaries and benefits | \$ 12,065 | 62.1% | \$ 5,446 | 64.6% | \$ 26,702 |
| General and administrative | 3,385 | 17.4% | 1,756 | 20.9% | 7,013 |
| Professional fees | 1,105 | 5.7% | 884 | 10.5% | 2,971 |
| Amortization of intangibles | 2,863 | 14.8% | 334 | 4.0% | 3,666 |
| | \$ 19,418 | 100.0% | \$ 8,420 | 100.0% | \$ 40,352 |

Total operating expenses and amortization for the quarter ended September 30, 2003 increased \$11.0 million compared to the same period last year due primarily to: (1) a \$6.6 million increase in salaries and benefits due primarily to: (i) \$4.7 million of expense from HCI; (ii) a \$1.9 million increase in salaries and benefits resulting from a \$0.9 million increase in salaries and other compensation and a \$1.0 million increase in bonus expense; (2) a \$2.5 million increase in amortization of intangibles due primarily to the amortization of capitalized asset management fee contracts from HCI; and (3) a \$1.6 million increase in general and administrative expenses due primarily to: (i) \$1.0 million of expense from HCI; and (ii) \$0.5 million in general and administrative expenses from the consolidated guaranteed tax credit equity funds.

Total operating expenses and amortization for the nine months ended September 30, 2003 increased \$14.5 million compared to the same period last year due primarily to: (1) a \$10.5 million increase in salaries and benefits due primarily to: (i) a \$5.8 million increase in salaries and benefits resulting from a \$1.9 million increase in salaries and other compensation and a \$3.9 million increase in bonus expense; and (ii) \$4.7 million of expense from HCI; (2) a \$2.7 million increase in amortization of intangibles due primarily to: (i) \$2.4 million of amortization of capitalized asset management fee contracts from HCI; and (ii) a \$0.2 million increase in amortization of mortgage servicing rights; (3) a \$1.8 million increase in general and administrative expenses due primarily to: (i) \$1.0 million of expense from HCI; (ii) \$0.5 million in general and administrative expenses from the consolidated guaranteed tax credit funds; and (iii) \$0.3 million increase due to integration costs related to the acquisition of HCI and an increase in unreimbursed deal expenses; and (4) a \$0.5 million decrease in professional fees due primarily to: (i) a \$1.4 million decrease in commission expense; (ii) a \$0.6 million increase in consulting fees due to an internal controls project and the acquisition of HCI; and (iii) \$0.1 million of expense from HCI.

Net Holding Gains on Derivatives

The Company recorded net holding gains for mark-to-market adjustments on derivative financial instruments of \$3.5 million for the quarter ended September 30, 2003 and net holding losses of \$9.9 million for the quarter ended September 30, 2002.

The Company recorded net holding gains for mark-to-market adjustments on derivative financial instruments of \$3.9 million for the nine months ended

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September 30, 2003 and net holding losses of \$14.5 million for the nine months ended September 30, 2002.

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Impairments and Valuation Allowances Related to Investments

In accordance with the Company's valuation and impairment policies, the Company did not record any other-than-temporary impairments during the quarters ended September 30, 2003 and September 30, 2002.

The Company recorded other-than-temporary impairments totaling \$1.1 million during the nine months September 30, 2003. The impairments included a \$0.7 million impairment on a bond with a face amount of \$19.5 million and \$0.4 million of impairments on three taxable loans with total face amounts of \$7.0 million. During the nine months ended September 30, 2002, the Company recorded impairments totaling \$0.1 million on a bond with a face amount of \$0.7 million.

Net Losses from Equity Investments in Partnerships

Net losses from equity investments in partnerships increased by \$0.1 million for the quarter ended September 30, 2003 compared to the same period last year due primarily to: (1) \$1.4 million in losses from the consolidated guaranteed tax credit equity funds; and (2) a \$1.6 million decrease in losses from an investment in income-producing real estate operating partnerships and related swap partnerships. While these investments generate cash flow to the Company in the form of quarterly distributions, on a GAAP basis they may generate a net loss due to non-cash adjustments for depreciation and mark-to-market adjustments related to the swap partnerships. The mark-to-market adjustments cause volatility in the losses that are recorded.

Net losses from equity investments in partnerships increased by \$2.2 million for the nine months ended September 30, 2003 compared to the same period last year due primarily to: (1) \$1.4 million in losses from the consolidated guaranteed tax credit equity funds; (2) \$1.1 million in losses generated from investments in real estate operating partnerships that are being warehoused before transfer to syndicated tax credit equity funds; and (3) a \$0.3 million decrease in losses from an investment in income-producing real estate operating partnerships and related swap partnerships.

Income Tax Expense

Income tax expense for the quarter ended September 30, 2003 decreased \$2.0 million compared to the same period last year. This decrease is due primarily to: (i) a decrease in net income within the operating segment, which contains corporations that are subject to income taxes; and (ii) an increase in deferred tax assets from HCI.

Income tax expense for the nine months ended September 30, 2003 decreased \$4.3 million compared to the same period last year. This decrease is due primarily to a decrease in net income within the operating segment, which contains corporations that are subject to income taxes.

Income Allocable to Preferred Shareholders and Minority Interests in Subsidiary Companies

As previously discussed, income allocable to preferred shareholders in a subsidiary company

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has been reclassified to interest expense for the quarter ended September 30, 2003. For the nine months ended September 30, 2003, income allocable to preferred shareholders in a subsidiary company decreased \$3.0 million compared to the same period in 2002 due to this reclassification.

Discontinued Operations

During the nine months ended September 30, 2003, the Company acquired a property by deed in lieu of foreclosure. This property previously served as collateral for a tax-exempt bond held by the Company. The Company sold the property for net proceeds of \$38.1 million, which resulted in a \$26.8 million gain. The \$26.8 million gain and \$1.0 million of losses from operations of the property were classified as discontinued operations in the consolidated statements of income.

Net Income

Net income for the quarter ended September 30, 2003 increased by \$17.9 million compared to the same period last year due primarily to: (1) a \$13.4 million decrease in net holding losses on derivatives; (2) a \$7.6 million increase in gain on sales; (3) a \$5.0 million increase in syndication fees; (4) a \$2.7 million increase in other income; (5) a \$2.2 million increase in asset management and advisory fees; offset by (6) a \$6.6 million increase in salaries and benefits; (7) a \$3.9 million increase in interest expense (excluding the reclassification of preferred share distributions); and (8) a \$2.5 million increase in amortization of intangibles.

Net income for the nine months ended September 30, 2003 increased by \$45.0 million compared to the same period last year due primarily to: (1) a \$25.7 million increase from discontinued operations; (2) an \$18.5 million decrease in net holding losses on derivatives; (3) a \$7.5 million increase in net gain on sales; (4) a \$5.8 million increase in other income; (5) a \$4.3 million decrease in income tax expense; (6) a \$2.6 million increase in asset management and advisory fees; offset by (7) a \$10.5 million increase in salaries and benefits; (8) a \$5.6 million increase in interest expense (excluding the reclassification of preferred share distributions); (9) a \$2.7 million increase in amortization of intangibles; and (10) a \$2.2 million increase in net losses from equity investments in partnerships.

Other Comprehensive Income (Loss)

For the quarter ended September 30, 2003, the net adjustment to other comprehensive income for unrealized holding losses on tax-exempt bonds and residual interests in bond securitizations available for sale was \$15.5 million. After a reclassification adjustment for gains of \$2.2 million included in net income, other comprehensive loss for the quarter ended September 30, 2003 was \$17.7 million and total comprehensive income was \$0.4 million.

For the quarter ended September 30, 2002, the net adjustment to other comprehensive income for unrealized holding gains on tax-exempt bonds and residual interests in bond securitizations available for sale was \$8.7 million. After a reclassification adjustment for gains of \$0.2 million included in net income, other comprehensive income for the quarter ended September 30, 2002 was \$8.5 million and total comprehensive income was \$8.8 million.

For the nine months ended September 30, 2003, the net adjustment to other comprehensive income for unrealized holding gains on tax-exempt bonds and residual interests in bond securitizations available for sale was \$5.6 million.

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After a reclassification adjustment for gains of \$27.0 million included in net income, other comprehensive loss for the nine months ended September 30, 2003 was \$21.4 million and total comprehensive income was \$41.8 million.

For the nine months ended September 30, 2002, the net adjustment to other comprehensive income for unrealized holding gains on tax-exempt bonds and residual interests in bond securitizations available for sale was \$7.6 million. After a reclassification adjustment for gains of \$1.2 million included in net income, other comprehensive income for the nine months ended September 30, 2002 was \$6.4 million and total comprehensive income was \$24.6 million.

RELATED PARTY TRANSACTIONS

The Company's 2002 Form 10-K contains a detailed description of the Company's related party transactions. During the third quarter of 2003, there has been no material change to the information related to related party transactions.

INCOME TAX CONSIDERATIONS

MuniMae is organized as a limited liability company. This structure allows MuniMae to combine the limited liability, governance and management characteristics of a corporation with the pass-through income features of a partnership. Therefore, the distributive share of MuniMae's income, deductions and credits is included in each shareholder's income tax return. In addition, the tax-exempt income derived from certain investments remains tax-exempt when it is passed through to the shareholders. MuniMae records cash dividends received from subsidiaries organized as corporations as dividend income for tax purposes. Shareholders' distributive share of MuniMae's income, deductions and credits are reported to shareholders on Internal Revenue Service Schedule K-1.

While the bulk of the Company's recurring interest income is tax-exempt, from time to time the Company may sell or securitize various assets, which may result in capital gains and losses for tax purposes. Since the Company is taxed as a partnership, these capital gains and losses are passed through to shareholders and are reported on each shareholder's Schedule K-1. Until January 1, 2003, the Company had elected under Section 754 of the Internal Revenue Code to adjust the tax basis of the Company's property on the transfer of shares to reflect the price each shareholder paid for its shares. As a result of the Company's Section 754 election, for shares purchased prior to January 1, 2003, the capital gain and loss allocated to those shares was determined on a shareholder-by-shareholder basis and will depend on, among other things, the timing of the shareholder's purchase of the shares, the timing of transactions that generate gains or losses for the Company and the difference (the "Basis Difference") between the Company's tax basis in its property and a shareholder's tax basis in the shares. This means that for assets purchased by the Company prior to a shareholder's purchase of shares, the shareholder's basis in the assets may be significantly different than the Company's basis in those same assets. Although the procedure for allocating the basis

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adjustment is complex, the result of the election is that each share is homogeneous, while each shareholder's basis in the assets of the Company may be different. Consequently, the capital gains and losses allocated to individual shareholders may be significantly different than the capital gains and losses recorded by the Company.

In January 2003, the Company applied to have its election under Section 754 of the Internal Revenue Code revoked. The Company applied for this revocation due to the increasing administrative burden attributable to this

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election resulting from the increased numbers of common shareholders and the increasing frequency both of events generating capital gain or loss and of purchases and sales of common shares.

In May 2003, the Internal Revenue Service approved the Company's application to revoke its election under Section 754 for the Company's tax year ending December 31, 2003. As a result, for common shares purchased on or after January 1, 2003, the capital gain and loss allocated from the Company will be based on their pro-rata share of the Company's gain and loss allocated without regard to the Basis Difference. In other words, for shares purchased prior to January 1, 2003, portions of the Basis Difference may from time to time be recognized and reported on the shareholder's Schedule K-1 as and when the Company's assets are sold. While for shares purchased on or after January 1, 2003, the Basis Difference will be eliminated when the shareholder sells the shares.

This change in the method of calculating the Company's tax basis in its assets could result in the shareholder being allocated more or less income in any given year than he or she would have received if the Section 754 election remained in place; however, it is difficult to predict the precise impact of the change for individual shareholders. The revocation of the Company's 754 election may result in shareholders who purchase shares on or after January 1, 2003, experiencing a difference in the overall character of income allocated or recognized.

A portion of the Company's interest income is derived from private activity bonds that for income tax purposes are considered tax preference items for purposes of alternative minimum tax ("AMT"). AMT is a mechanism within the Internal Revenue Code to ensure that all taxpayers pay at least a minimum amount of taxes. All taxpayers are subject to the AMT calculation requirements although the majority of taxpayers will not actually pay AMT. As a result of AMT, the percentage of the Company's income that is exempt from federal income tax may be different for each shareholder depending on that shareholder's individual tax situation.

The Company has numerous corporate subsidiaries that are subject to income taxes. The Company provides for income taxes in accordance with Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" ("FAS 109"). FAS 109 requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the financial statement carrying amounts and the tax basis of assets and liabilities.

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Item 3. Quantitative and Qualitative Disclosures about Market Risk

Since December 31, 2002 there has been no material change to the information included in Item 7A of the Company's 2002 Form 10-K.

Item 4. Controls and Procedures

(a) Evaluation of disclosure controls and procedures

The term "disclosure controls and procedures" is defined in Rules 13a-14(c) and 15d-14(c) of the Securities and Exchange Act of 1934 (the "Exchange Act"). These rules refer to the controls and other procedures of a company that are designed to ensure that information required to be disclosed by

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a company in the reports that it files under the Exchange Act is recorded, processed, summarized and reported within required time periods. Our Chief Executive Officer and our Chief Financial Officer have evaluated the effectiveness of our disclosure controls and procedures as of the end of the reporting period (the "Evaluation Date"), and they have concluded that, as of the Evaluation Date, such controls and procedures were effective at ensuring that required information will be disclosed on a timely basis in our reports filed under the Exchange Act.

(b) Changes in internal controls

We maintain a system of internal accounting controls that are designed to provide reasonable assurance that our books and records accurately reflect our transactions and that our established policies and procedures are followed. For the quarter ended September 30, 2003, there were no significant changes to our internal controls or in other factors that could significantly affect our internal controls.

PART II. OTHER INFORMATION

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits:

- 10.1 Credit and Guarantee Agreement dated as of July 1, 2003.
- 31.1 Certification of Mark K. Joseph, Chief Executive Officer of Municipal Mortgage & Equity, LLC Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of William S. Harrison, Chief Financial Officer of Municipal Mortgage & Equity, LLC Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

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- 32.1 Certification of Mark K. Joseph, Chief Executive Officer and Chairman of the Board of Municipal Mortgage & Equity, LLC Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of William S. Harrison, Chief Financial Officer of Municipal Mortgage Equity, LLC Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Reports on Form 8-K:

On July 10, 2003, the Company filed a Current Report on Form 8-K under Items 2 and 5 and furnished information under Item 7, as amended on September 15, 2003 and September 17, 2003, announcing the completion of the Company's acquisition of the Housing and Community Investing (HCI) business of Lend Lease Real Estate Investments and containing the Purchase and Sale Agreement by and among Lend Lease Corporation Limited, BF-GP, Inc., Lend Lease (US) Services, Inc., Lend Lease Real Estate Investments, Inc., Midland Financial Holdings, Inc. and MMA Financial, Inc. dated as of May 14, 2003 and the unaudited pro forma combined balance sheet of the Company as of June 30,

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2003 and the unaudited pro forma combined statements of operations of the Company for the year ended December 31, 2002 and the six months ended June 30, 2003.

On July 18, 2003, the Company filed a Current Report on Form 8-K under Item 5, announcing the appointment of a new board member.

On July 18, 2003, the Company furnished a Current Report on Form 8-K under Items 7 and 12, as amended on August 13, 2003, containing the earnings package distributed to the securities analysts for the quarter ended June 30, 2003, an earnings press release and financial statements related to the Company's performance for the quarter ended June 30, 2003 and a production press release related to the Company's production volume for the quarter ended June 30, 2003.

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SIGNATURES

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

DATE: November 13, 2003

MUNICIPAL MORTGAGE & EQUITY, LLC

By: /s/ Mark J. Joseph

Mark K. Joseph
Chairman of the Board and Chief Executive
Officer

DATE: November 13, 2003

By: /s/ Mark K. Joseph

Mark K. Joseph
Chairman of the Board, Chief Executive
Officer (Principal Executive Officer), and
Director

DATE: November 13, 2003

By: /s/ William S. Harrison

William S. Harrison
Chief Financial Officer (Principal Financial
Officer and Principal Accounting Officer)

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EXHIBIT INDEX

- 10.1 Guarantee and Credit Agreement dated as of July 1, 2003.
- 31.1 Certification of Mark K. Joseph, Chief Executive Officer of Municipal Mortgage & Equity, LLC Pursuant to Section 302

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of the Sarbanes-Oxley Act of 2002.

- 31.2 Certification of William S. Harrison, Chief Financial Officer of Municipal Mortgage & Equity, LLC Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Mark K. Joseph, Chief Executive Officer and Chairman of the Board of Municipal Mortgage & Equity, LLC Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of William S. Harrison, Chief Financial Officer of Municipal Mortgage & Equity, LLC Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.