



# Newcastle

Investment Corp.

Annual Report 2011



**Newcastle Investment Corp.** (NYSE: NCT) is a real estate investment company that invests in real estate debt and excess mortgage servicing rights. Newcastle focuses on generating strong operating results and making new investments to drive dividend growth. Newcastle is organized and conducts its operations to qualify as a real estate investment trust (REIT) and is managed by an affiliate of Fortress Investment Group, a global investment management firm.

## Fellow Shareholders:

2011 was a great year for Newcastle. We posted strong financial results and made continued progress increasing operating cash flows, deleveraging and optimizing our portfolio. In addition, we made our first investment in excess mortgage servicing rights, an area that represents exciting growth potential.

We entered 2011 with a strong balance sheet and I am excited about our financial results for the year. We earned \$254 million or \$3.09 per share of GAAP income and increased book value by \$440 million or \$6.22 per share. Core earnings were \$118 million or \$1.44 per share and cash flow available for distribution increased by 83% to \$77 million from \$42 million in 2010.

Since mid 2008, we have focused on building shareholder value by retaining cash to materially deleverage our balance sheet and improve operating results. In the last three years, we have repurchased more than \$975 million of our debt at a significant discount to par and tendered for 60% of our preferred shares, re-building GAAP book value by \$638 million.

With those important elements of progress achieved, our Board voted to reinstate our dividend to common shareholders in 2011, reflecting its confidence in the financial strength and prospects of our company. We paid a dividend of \$0.10 per share in the 2<sup>nd</sup> quarter and subsequently increased it by 50% to \$0.15 in the 3<sup>rd</sup> and 4<sup>th</sup> quarters.

Highlighted below are several contributing factors that allowed us to increase cash available for distribution and reinstate our common stock dividend:

- Raised \$211 million of common equity and invested \$193 million of unrestricted cash at an anticipated return of approximately 20%.
- Invested \$858 million of restricted cash to purchase \$949 million of assets in our CDOs at an average price of 90% of par and an unleveraged yield of 8%, resulting in leveraged returns of over 20%.
- Repurchased \$174 million of CDO debt at an average price of 61% of par.
- Refinanced our \$197 million manufactured housing loan portfolio with \$160 million of non-recourse debt. With this refinancing, we reduced our funding cost 160 basis points from 5.30% to 3.70%. For the year, we generated \$9 million of cash flow from this portfolio.

The economy continues to stabilize and housing prices seem to be near the bottom. The year started off with rising asset prices and, while prices weakened later in the year, credit markets remained open and liquidity steadily improved. In our view, this indicates that the recovery in the credit markets is on solid footing. Although credit spreads widened in 2011, the continued lack of new issue supply in the residential and commercial real estate debt markets should drive prices higher, resulting in increased valuations of our securities and loan portfolio, where we see meaningful upside. At year end, the average carrying value of our \$3.9 billion real estate securities and loan portfolio was \$3.0 billion or 76.8% of par. Since this portfolio is almost entirely match funded with \$2.8 billion of mostly non-recourse debt, we have the ability to hold it to maturity and realize much of that potential upside. The funding cost of our debt is low at 2.7% and our assets yield 9.6%. The average life of this portfolio is 4 years, and the average life of our financing is 3.4 years. The roughly \$1 billion difference between the par value and the carrying value of our assets represents potential upside for Newcastle and our shareholders, and we are focused on realizing this value in the years to come.

In December 2011, we completed our first investment in excess mortgage servicing rights and, in March 2012, we announced an agreement to acquire a large second Excess MSR portfolio. This represents a new investment area for Newcastle and a tremendous opportunity.

A mortgage servicing right (or “MSR”) is a contractual fee payable to a servicer for loan collections, payment processing, and special servicing of delinquent or troubled loans. A typical MSR fee is 30 to 35 basis points paid on the principal balance of a loan. An Excess MSR represents the portion of the MSR that is in excess of the base fee charged by the servicer to service the loan (typically 5 to 10 basis points). As an example, if the MSR fee is 30 basis points and the base fee to service the loan is 10 basis points, the resulting Excess MSR is 20 basis points.

Our investment strategy is to partner with a strong mortgage servicer to acquire Excess MSR. With this approach, the servicer owns the MSR and performs all the day-to-day servicing functions, for 10 basis points in our example. We co-invest alongside the servicer in the excess portion of the MSR (the 20 basis points in our example). The investment opportunity is compelling for 3 primary reasons:

*First*—there are more sellers of MSRs than there are buyers

*Second*—there are significant barriers to entry to making investments in Excess MSRs

*Third*—the investments should generate 15 to 20% returns without leverage

**Attractive Supply/Demand Imbalance**—The amount of MSRs for sale is large and growing. We estimate that there are more than \$700 billion (\$4 to \$5 billion investment amount) of MSRs currently for sale. Banks, which currently own over 90% of the \$10 trillion MSR market, are under pressure to sell due to changes in bank regulatory and capital requirements. The sale and ownership transfer of MSRs from banks to non-bank servicers is underway, with over \$275 billion in sales to date. We believe this trend will continue, representing a substantial opportunity for Newcastle.

**Significant Barriers to Entry**—There are significant barriers to entry to investing in Excess MSRs. At the end of 2011, Newcastle received a private letter ruling from the Internal Revenue Service categorizing our investment in Excess MSRs as a qualified REIT asset and the income generated as good REIT income. We are currently the only company with that qualification. To pursue these investments, we have partnered with Nationstar Mortgage, an affiliate of our manager Fortress Investment Group. Nationstar has a strong servicing track record and capital to invest alongside us; they are also one of the few non-bank servicers with the ability to originate loans and offer one stop refinancing services to existing borrowers. This is critical because loans refinanced (or “recaptured”) by Nationstar continue to generate cash flow to our Excess MSR while loans refinanced by others do not. These factors give us a significant competitive advantage and are key to successfully investing in Excess MSRs.

**Compelling Investment Returns**—In December, we invested \$44 million to purchase a 65% interest in the Excess MSRs of a \$9.9 billion pool of mortgage loans. We expect total lifetime cash flows to be \$92 million or 2.1 times our investment with an average life of 6 years, resulting in a 20% IRR. In the first few months since we closed, the investment is performing better than expected. Our second Excess MSR investment, announced in March 2012, totals approximately \$170 million and is expected to close in the 2<sup>nd</sup> quarter. These transactions demonstrate our ability to invest capital in the MSR market and we are seeing a strong deal pipeline.

We are off to a good start in 2012. We recently announced a 33% increase in our quarterly dividend to \$0.20 per share. Our balance sheet is strong, our operating results are improving and we will continue to focus on new investments to grow. We also see potential upside in the value difference between the face amount of our securities and loan portfolio and the current carrying value. On behalf of everyone at Newcastle, we are excited about our business and its prospects and we thank you for your continued support. We had a great year, but we are in the early innings of a new investment and growth phase. We remain focused and committed to position the company for success.



**Kenneth M. Riis**

Chief Executive Officer and President

March 21, 2012



**Newcastle**  
Investment Corp.

Form 10-K



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

Form 10-K

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

For the fiscal year ended December 31, 2011

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 001-31458

Newcastle Investment Corp.

(Exact name of registrant as specified in its charter)

Maryland

(State or other jurisdiction of  
incorporation or organization)

1345 Avenue of the Americas,  
New York, NY

(Address of principal executive offices)

81-0559116

(I.R.S. Employer  
Identification No.)

10105

(Zip Code)

Registrant's telephone number, including area code: (212) 798-6100

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

Title of each class:	Name of exchange on which registered:
Common Stock, \$0.01 par value per share	New York Stock Exchange (NYSE)
9.75% Series B Cumulative Redeemable Preferred Stock, \$0.01 par value per share	New York Stock Exchange (NYSE)
8.05% Series C Cumulative Redeemable Preferred Stock, \$0.01 par value per share	New York Stock Exchange (NYSE)
8.375% Series D Cumulative Redeemable Preferred Stock, \$0.01 par value per share	New York Stock Exchange (NYSE)

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

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

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

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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).  Yes  No

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

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

Large Accelerated Filer  Accelerated Filer  Non-accelerated Filer  Smaller Reporting Company

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

The aggregate market value of the common stock held by non-affiliates as of June 30, 2011 (computed based on the closing price on such date as reported on the NYSE) was: \$434 million.

The number of shares outstanding of the registrant's common stock was 105,181,009 as of February 29, 2012.

## CAUTIONARY NOTE REGARDING FORWARD LOOKING STATEMENTS

This report contains certain “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements relate to, among other things, the operating performance of our investments, the stability of our earnings, and our financing needs. Forward-looking statements are generally identifiable by use of forward-looking terminology such as “may,” “will,” “should,” “potential,” “intend,” “expect,” “endeavor,” “seek,” “anticipate,” “estimate,” “overestimate,” “underestimate,” “believe,” “could,” “project,” “predict,” “continue” or other similar words or expressions. Forward-looking statements are based on certain assumptions, discuss future expectations, describe future plans and strategies, contain projections of results of operations or of financial condition or state other forward-looking information. Our ability to predict results or the actual outcome of future plans or strategies is inherently uncertain. Although we believe that the expectations reflected in such forward-looking statements are based on reasonable assumptions, our actual results and performance could differ materially from those set forth in the forward-looking statements. These forward-looking statements involve risks, uncertainties and other factors that may cause our actual results in future periods to differ materially from forecasted results. Factors which could have a material adverse effect on our operations and future prospects include, but are not limited to:

- reductions in cash flows received from our investments;
- our ability to take advantage of opportunities in additional asset classes or types of assets, at attractive risk-adjusted prices;
- our ability to take advantage of investment opportunities in interests in excess mortgage servicing rights;
- our ability to deploy capital accretively;
- the risks that default and recovery rates on our real estate securities and loan portfolios deteriorate compared to our underwriting estimates;
- the relationship between yields on assets which are paid off and yields on assets in which such monies can be reinvested;
- the relative spreads between the yield on the assets we invest in and the cost of financing;
- changes in economic conditions generally and the real estate and bond markets specifically;
- adverse changes in the financing markets we access affecting our ability to finance our investments, or in a manner that maintains our historic net spreads;
- changing risk assessments by lenders that potentially lead to increased margin calls, not extending our repurchase agreements or other financings in accordance with their current terms or entering into new financings with us;
- changes in interest rates and/or credit spreads, as well as the success of any hedging strategy we may undertake in relation to such changes;
- the quality and size of the investment pipeline and the rate at which we can invest our cash, including cash inside our CDOs;
- impairments in the value of the collateral underlying our investments and the relation of any such impairments to our judgments as to whether changes in the market value of our securities, loans or real estate are temporary or not and whether circumstances bearing on the value of such assets warrant changes in carrying values;
- legislative/regulatory changes, including but not limited to, any modification of the terms of loans;
- the availability and cost of capital for future investments;
- competition within the finance and real estate industries; and
- other risks detailed from time to time below, particularly under the heading “Risk Factors,” and in our other SEC reports.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. The factors noted above could cause our actual results to differ significantly from those contained in any forward-looking statement.

Readers are cautioned not to place undue reliance on any of these forward-looking statements, which reflect our management’s views only as of the date of this report. We are under no duty to update any of the forward-looking statements after the date of this report to conform these statements to actual results.

## **SPECIAL NOTE REGARDING EXHIBITS**

In reviewing the agreements included as exhibits to this Annual Report on Form 10-K, please remember they are included to provide you with information regarding their terms and are not intended to provide any other factual or disclosure information about the Company or the other parties to the agreements. The agreements contain representations and warranties by each of the parties to the applicable agreement. These representations and warranties have been made solely for the benefit of the other parties to the applicable agreement and:

- should not in all instances be treated as categorical statements of fact, but rather as a way of allocating the risk to one of the parties if those statements provide to be inaccurate;
- have been qualified by disclosures that were made to the other party in connection with the negotiation of the applicable agreement, which disclosures are not necessarily reflected in the agreement;
- may apply standards of materiality in a way that is different from what may be viewed as material to you or other investors; and
- were made only as of the date of the applicable agreement or such other date or dates as may be specified in the agreement and are subject to more recent developments.

Accordingly, these representations and warranties may not describe the actual state of affairs as of the date they were made or at any other time. Additional information about the Company may be found elsewhere in this Annual Report on Form 10-K and the Company's other public filings, which are available without charge through the SEC's website at <http://www.sec.gov>. See "Business – Corporate Governance and Internet Address; Where Readers Can Find Additional Information."

The Company acknowledges that, notwithstanding the inclusion of the foregoing cautionary statements, it is responsible for considering whether additional specific disclosures of material information regarding material contractual provisions are required to make the statements in this report not misleading.

**NEWCASTLE INVESTMENT CORP.**  
**FORM 10-K**

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## PART I

### Item 1. Business.

#### Overview

Newcastle Investment Corp. (“Newcastle”) is a real estate investment and finance company. Newcastle invests in, and actively manages, a portfolio of real estate securities, loans, excess mortgage servicing rights (“excess MSRs”) and other real estate related assets. Our objective is to maximize the difference between the yield on our investments and the cost of financing these investments while hedging our interest rate risk, where feasible and appropriate. We emphasize portfolio management, asset quality, liquidity, diversification, match funded financing and credit risk management.

We conduct our business through the following segments: (i) investments financed with non-recourse collateralized debt obligations (“non-recourse CDOs”), (ii) unlevered investments in deconsolidated Newcastle CDO debt (“unlevered CDOs”), (iii) unlevered excess MSRs, (iv) investments financed with other non-recourse debt (“non-recourse other”), (v) investments and debt repurchases financed with recourse debt (“recourse”), (vi) other unlevered investments (“unlevered other”) and (vii) corporate. In the fourth quarter of 2011, Newcastle changed the composition of its reportable segments such that the unlevered segment is further broken down into (i) unlevered CDOs, (ii) unlevered excess MSRs and (iii) unlevered other. Accordingly, segment information for previously reported periods has been restated to reflect the new composition of reportable segments. Further details regarding the revenues, net income (loss) and total assets of each of our segments for each of the last three fiscal years are presented in Note 3 to Part II, Item 8, “Financial Statements and Supplementary Data.”

The following table summarizes our segments at December 31, 2011:

	Non- Recourse CDOs (A)	Unlevered CDOs (B)	Unlevered Excess MSRs	Non- Recourse Other (A)(C)	Recourse (D)	Unlevered Other (E)	Corporate	Inter-segment Elimination (F)	Total
GAAP									
Investments	\$2,408,252	\$ 3,940	\$ 43,971	\$ 783,777	\$244,916	\$ 18,751	\$ -	\$ (143,018)	\$3,360,589
Cash and restricted cash	105,040	-	-	-	-	9	157,347	-	262,396
Derivative assets	1,954	-	-	-	-	-	-	-	1,954
Other assets	23,203	8	-	116	593	2,085	1,208	(353)	26,860
Total assets	2,538,449	3,948	43,971	783,893	245,509	20,845	158,555	(143,371)	3,651,799
Debt	(2,410,151)	-	-	(748,118)	(233,194)	-	(51,248)	143,018	(3,299,693)
Derivative liabilities	(119,320)	-	-	-	-	-	-	-	(119,320)
Other liabilities	(12,705)	-	(4,186)	(3,407)	(23)	(49)	(20,680)	353	(40,697)
Total liabilities	(2,542,176)	-	(4,186)	(751,525)	(233,217)	(49)	(71,928)	143,371	(3,459,710)
Preferred stock	-	-	-	-	-	-	(61,583)	-	(61,583)
GAAP book value	\$ (3,727)	\$ 3,948	\$ 39,785	\$ 32,368	\$ 12,292	\$ 20,796	\$ 25,044	\$ -	\$ 130,506

- (A) Assets held within CDOs and other non-recourse structures are not available to satisfy obligations outside of such financings, except to the extent we receive net cash flow distributions from such structures. Furthermore, creditors or beneficial interest holders of these structures have no recourse to the general credit of Newcastle. Therefore, our exposure to the economic losses from such structures is limited to our invested equity in them and economically their book value cannot be less than zero. Therefore, impairment recorded in excess of our investment, which results in negative GAAP book value for a given non-recourse financing structure, cannot economically be incurred and will eventually be reversed through amortization, sales at gains, or as gains at the deconsolidation or termination of such non-recourse financing structure.
- (B) Represents unlevered investments in CDO securities issued by Newcastle. These CDOs have been deconsolidated as we do not have the power to direct the relevant activities of the CDOs.
- (C) The following table summarizes the investments and debt in the other non-recourse segment:

	December 31, 2011			
	Investments		Debt	
	Outstanding Face Amount	Carrying Value	Outstanding Face Amount*	Carrying Value*
Manufactured housing loan portfolio I	\$ 135,209	\$ 112,316	\$ 107,032	\$ 97,631
Manufactured housing loan portfolio II	178,603	175,120	143,869	142,589
Residential mortgage loans	56,377	40,380	54,842	53,771
Subprime mortgage loans subject to call options	406,217	404,723	406,217	404,723
Real estate securities	67,965	43,497	47,697	43,404
Operating real estate	N/A	7,741	6,000	6,000
	<u>\$ 844,371</u>	<u>\$ 783,777</u>	<u>\$ 765,657</u>	<u>\$ 748,118</u>

\* An aggregate face amount of \$157.0 million (carrying value of \$143.0 million) of debt represents financing provided by the CDO segment (and included as investments in the CDO segment), which is eliminated upon consolidation.

(D) The \$233.2 million of recourse debt is comprised of (i) \$231.0 million of repurchase agreements secured by \$244.9 million carrying amount of FNMA/FHLMC securities and (ii) \$2.2 million of repurchase agreements secured by \$29.1 million face amount of senior notes issued by Newcastle CDO VI, which was repurchased by Newcastle in December 2010 and eliminated in consolidation.

(E) The following table summarizes the investments in the unlevered other segment as of December 31, 2011:

	Outstanding Face Amount	Carrying Value	Number of Investments
Real estate securities	\$ 183,507	\$ 7,614	25
Real estate related loans	24,543	6,366	1
Residential mortgage loans	5,227	2,687	170
Other investments	N/A	6,024	1
	<u>\$ 213,277</u>	<u>\$ 22,691</u>	<u>197</u>

(F) Represents the elimination of investments and financings and their related income and expenses between the CDO segment and the other non-recourse segment as the corresponding inter-segment investments and financings are presented on a gross basis within each of these segments.

Our investments currently cover the following distinct categories:

- 1) Real Estate Securities: We underwrite, acquire and manage a diversified portfolio of credit sensitive real estate securities, including commercial mortgage backed securities (CMBS), senior unsecured REIT debt issued by REITs, real estate related asset backed securities (ABS), including subprime securities, and FNMA/FHLMC securities. As of December 31, 2011, our real estate securities represented 47.4% of our assets.
- 2) Real Estate Related Loans: We acquire and originate loans to real estate owners, including B-notes, mezzanine loans, corporate bank loans, and whole loans. As of December 31, 2011, our real estate related loans represented 22.3% of our assets.
- 3) Residential Mortgage Loans: We acquire residential mortgage loans, including manufactured housing loans and subprime mortgage loans. As of December 31, 2011, our residential mortgage loans represented 9.1% of our assets.
- 4) Operating Real Estate: We acquire and manage direct and indirect interests in operating real estate. As of December 31, 2011, our operating real estate represented 0.9% of our assets.
- 5) Excess Mortgage Servicing Rights: We made our first investment in excess MSR in December 2011. As of December 31, 2011, our interests in these rights represented 1.2% of our assets.

In addition, Newcastle had restricted and unrestricted cash and other miscellaneous net assets, which represented 19.1% of our assets at December 31, 2011.

Newcastle's stock is traded on the New York Stock Exchange under the symbol "NCT." Newcastle is a real estate investment trust for federal income tax purposes and is externally managed and advised by an affiliate of Fortress Investment Group LLC, or Fortress. For its services, our manager is entitled to a management fee and incentive compensation pursuant to a management agreement. Fortress, through its affiliates, and principals of Fortress collectively owned 4.8 million shares of our common stock and Fortress, through its affiliates, had options to purchase an additional 6.0 million shares of our common stock, which were issued in connection with our equity offerings, representing approximately 9.7% of our common stock on a fully diluted basis, as of December 31, 2011.

During the year ended December 31, 2011, Newcastle actively pursued opportunities to raise capital and make new investments at attractive yields.

Highlighted below are the significant transactions executed during the year.

- In February 2011, Newcastle, through one of its subsidiaries, purchased the management rights with respect to certain C-BASS Investment Management LLC ("C-BASS") CDOs pursuant to a bankruptcy proceeding for \$2.2 million. As a result, Newcastle became the collateral manager of certain CDOs previously managed by C-BASS and

will earn, on average, a 20 basis point annual senior management fee on a portion of the total collateral, which was \$1.3 billion at acquisition.

- In March 2011, Newcastle issued 17,250,000 shares of its common stock in a public offering at a price to the public of \$6.00 per share for net proceeds of approximately \$98.4 million. In September 2011, Newcastle issued 25,875,000 shares of its common stock in a public offering at a price to the public of \$4.55 per share for net proceeds of approximately \$112.3 million.
- In May 2011, we completed a securitization transaction to refinance approximately \$197 million outstanding principal balance of manufactured housing loans. We issued approximately \$160 million aggregate principal amount of asset-backed notes, of which \$143 million was sold to third parties and \$17 million was sold to certain CDOs managed and consolidated by us. In addition, we retained the below investment grade notes and residual interest, and invested approximately \$20 million of unrestricted cash in the new securitization structure. The gross proceeds received from the issuance of the notes were used to repay the previously existing financing on this portfolio in full, terminate the related interest rate swap contracts and pay the related transaction costs.
- In December 2011, we made our first investment in excess MSR. We invested \$44 million to acquire a 65% interest in the excess MSR of a \$9.9 billion residential mortgage portfolio. Nationstar Mortgage LLC (“Nationstar”), a leading residential mortgage servicer that is externally managed by our manager, is the servicer of the loans and invested alongside Newcastle by acquiring the remaining 35% interest in the excess MSR. To the extent any loans in this portfolio are refinanced by Nationstar, subject to certain limitations, we are entitled to receive our pro rata share of the excess MSR of the refinanced loans. Newcastle will not have any servicing duties, advance obligations or liabilities associated with the portfolio.
- As a result of the improvement in our financial condition and liquidity, the Board of Directors reinstated the quarterly dividend on our common stock beginning in the second quarter of 2011, and declared aggregate common stock dividends of \$0.40 per share, or \$39.5 million, for the year ended December 31, 2011.

## Our Investment Strategy

Newcastle's investment strategy focuses predominantly on debt investments secured by real estate. Our investment guidelines are purposefully broad to enable us to make investments in a wide array of assets, including, but not limited to, any assets that can be held by real estate investment trusts. We do not have specific policies as to the allocation among type of real estate related assets or investment categories since our investment decisions depend on changing market conditions. Instead, we focus on relative value and in-depth risk/reward analysis. Our focus on relative value means that assets which may be unattractive under particular market conditions may, if priced appropriately to compensate for risks such as projected defaults and prepayments, become attractive relative to other available investments. We generally utilize a match funded financing strategy, when appropriate and available, and active management as part of our investment strategy.

The following summarizes our consolidated investment portfolio at December 31, 2011 (dollars in millions):

	Outstanding Face Amount	Amortized Cost Basis (1)	Percentage of Total Amortized Cost Basis	Carrying Value	Number of Investments	Credit (2)	Weighted Average Life (years) (3)
<b>Investment (7)</b>							
<b>I. Real Estate Related Investments</b>							
<b>Commercial</b>							
CMBS	\$ 1,546	\$ 1,124	38.2%	\$ 1,129	204	BB+	4.1
Mezzanine Loans	609	469	15.9%	469	17	73%	2.4
B-Notes	174	153	5.2%	153	5	61%	2.8
Whole Loans	31	31	1.0%	31	3	48%	1.9
CDO Securities (4)	88	68	2.3%	56	3	BB+	3.5
Other Investments (5)	25	25	0.8%	25	1	--	-
<b>Total Commercial Assets</b>	<b>2,473</b>	<b>1,870</b>	<b>63.4%</b>	<b>1,863</b>			<b>3.5</b>
<b>Residential</b>							
Manufactured Housing and Residential	379	328	11.1%	328	10,045	704	6.6
Subprime Securities	246	123	4.2%	129	63	B	6.9
Real Estate ABS	53	40	1.4%	38	14	BBB-	7.2
	678	491	16.7%	495			6.7
FNMA/FHLMC securities	232	243	8.3%	245	31	AAA	4.6
<b>Total Residential Assets</b>	<b>910</b>	<b>734</b>	<b>25.0%</b>	<b>740</b>			<b>6.2</b>
<b>Corporate</b>							
REIT Debt	137	136	4.6%	135	20	BB+	2.4
Corporate Bank Loans	283	161	5.5%	161	6	CC	3.0
<b>Total Corporate Assets</b>	<b>420</b>	<b>297</b>	<b>10.1%</b>	<b>296</b>			<b>2.8</b>
<b>II. Excess Mortgage Servicing Rights</b>	<b>44</b>	<b>44</b>	<b>1.5%</b>	<b>44</b>	<b>1</b>	<b>--</b>	<b>6.0</b>
<b>TOTAL / WA</b>	<b>\$ 3,847</b>	<b>\$ 2,945</b>	<b>100.0%</b>	<b>\$ 2,943</b>			<b>4.1</b>
Reconciliation to GAAP total assets:							
Other assets							
Subprime mortgage loans subject to call option (6)				405			
Real estate held for sale				8			
Cash and restricted cash				262			
Other				34			
<b>GAAP total assets</b>				<b>\$ 3,652</b>			

WA – Weighted average, in all tables.

- (1) Net of impairments.
- (2) Credit represents the weighted average of minimum rating for rated assets, the loan-to-value ratio (based on the appraised value at the time of purchase or refinancing) for non-rated commercial assets, or the FICO score for non-rated residential assets and an implied AAA rating for FNMA/FHLMC securities. Ratings provided above were determined by third party rating agencies as of a particular date, may not be current and are subject to change at any time.
- (3) Weighted average life is based on the timing of expected principal reduction on the asset.
- (4) Represents non-consolidated CDO securities, excluding ten securities with a zero value, which had an aggregate face amount of \$118 million.
- (5) Represents an equity investment in a real estate owned property.
- (6) Our subprime mortgage loans subject to call option are excluded from the statistics because they result from an option, not an obligation, to repurchase such loans, are noneconomic until such option is exercised, and are offset by an equal liability on the consolidated balance sheet.
- (7) The following tables summarize certain supplemental data relating to our investments (dollars in tables in thousands):

## CMBS

Deal Vintage (A)	Average Minimum Rating (B)	Number	Outstanding Face Amount	Amortized Cost Basis	Percentage of Total Amortized Cost Basis	Carrying Value	Delinquency 60+/FC/REO (C)	Principal Subordination (D)	Weighted Average Life (years) (E)
Pre 2004	BB+	60	\$ 301,373	\$ 283,342	25.2%	\$ 263,447	7.3%	14.4%	1.5
2004	BB+	31	143,831	113,231	10.1%	105,349	2.3%	7.7%	3.4
2005	BB+	29	317,865	192,387	17.1%	219,565	5.2%	8.5%	3.6
2006	BB	44	409,417	281,889	25.1%	275,951	8.1%	11.8%	3.8
2007	B-	16	121,638	35,266	3.1%	52,362	16.2%	10.9%	4.3
2010	BB+	4	46,798	43,499	3.9%	42,129	0.0%	3.5%	8.8
2011	BBB	20	204,955	174,832	15.5%	170,015	0.0%	7.2%	8.5
Total / WA	BB+	204	\$ 1,545,877	\$ 1,124,446	100.0%	\$ 1,128,818	6.1%	10.3%	4.1

(A) The year in which the securities were issued.

(B) Ratings provided above were determined by third party rating agencies as of a particular date, may not be current and are subject to change at any time. We had \$2.3 million of CMBS assets that were on negative watch for possible downgrade by at least one rating agency as of December 31, 2011.

(C) The percentage of underlying loans that are 60+ days delinquent, or in foreclosure or considered real estate owned (REO).

(D) The percentage of the outstanding face amount of securities that is subordinate to our investments.

(E) Weighted average life is based on the timing of expected principal reduction on the asset.

## CDO Securities (A)

Collateral Manager	Primary Collateral Type	Number	Average Minimum Rating (B)	Outstanding Face Amount	Amortized Cost Basis	Percentage of Total Amortized Cost Basis	Carrying Value	Principal Subordination (C)
Third Party	CMBS	1	BBB-	\$ 77,027	\$ 60,801	89.9%	\$ 49,296	51.7%
Newcastle	CMBS	1	BBB-	5,502	4,224	6.2%	3,940	29.5%
Newcastle	ABS	1	CC	5,500	2,600	3.9%	2,750	49.1%
TOTAL/WA		3	BB+	\$ 88,029	\$ 67,625	100.0%	\$ 55,986	50.2%

(A) Represents non-consolidated CDO securities, excluding ten securities with a zero value, which had an aggregate face amount of \$118 million.

(B) Ratings provided above were determined by third party rating agencies as of a particular date, may not be current and are subject to change at any time.

(C) The percentage of the outstanding face amount of securities that is subordinate to our investments.

## Mezzanine Loans, B-Notes and Whole Loans

Asset Type	Number	Outstanding Face Amount	Amortized Cost Basis	Percentage of Total Amortized Cost Basis	Carrying Value	Weighted Average First Dollar Loan to Value (A)	Weighted Average Last Dollar Loan to Value (A)	Delinquency (B)
Mezzanine Loans	17	\$ 609,117	\$ 469,326	71.9%	\$ 469,326	60.8%	73.2%	2.0%
B-Notes	5	174,153	152,535	23.4%	152,535	50.5%	60.7%	31.2%
Whole Loans	3	30,566	30,566	4.7%	30,566	0.0%	48.2%	0.0%
Total/WA	25	\$ 813,836	\$ 652,427	100.0%	\$ 652,427	56.3%	69.6%	8.2%

(A) Loan to value is based on the appraised value at the time of purchase or refinancing.

(B) The percentage of underlying loans that are non-performing, in foreclosure, under bankruptcy filing or considered real estate owned.

## Manufactured Housing and Residential Loans

Deal	Average FICO Score (A)	Outstanding Face Amount	Amortized Cost Basis	Percentage of Total Amortized Cost Basis	Carrying Value	Average Loan Age (years)	Original Balance	Delinquency 90+/FC/REO (B)	Cumulative Loss to Date
Manufactured Housing Loans Portfolio I	702	\$ 135,977	\$ 110,528	33.6%	\$ 110,528	10.2	\$ 327,855	1.5%	7.9%
Manufactured Housing Loans Portfolio II	702	183,062	174,331	53.1%	174,331	12.6	434,743	1.7%	6.2%
Residential Loans Portfolio I	714	56,377	40,270	12.3%	40,270	8.7	646,357	12.1%	0.4%
Residential Loans Portfolio II	737	3,779	3,415	1.0%	3,415	7.3	83,950	0.0%	0.0%
Total / WA	704	\$ 379,195	\$ 328,544	100.0%	\$ 328,544	11.1	\$ 1,492,905	3.2%	5.9%

(A) Based on updated FICO scores provided by the loan servicer of the manufactured housing loan portfolios and original FICO scores for the residential loan portfolios as the loan servicers of the residential loan portfolios do not provide updated FICO scores.

(B) The percentage of loans that are 90+ days delinquent, or in foreclosure or considered real estate owned.

## Subprime Securities <sup>(A)</sup>

Vintage (B)	Security Characteristics								
	Average Minimum Rating (C)	Number of Securities	Outstanding Face Amount	Amortized Cost Basis	Percentage of Total Amortized Cost Basis	Carrying Value	Principal Subordination (D)	Excess Spread (E)	
2003	B-	14	\$ 14,063	\$ 6,805	5.5%	\$ 8,116	24.7%	4.2%	
2004	BB-	9	34,567	16,483	13.4%	18,117	25.2%	3.7%	
2005	B-	26	108,265	41,463	33.7%	42,840	32.1%	4.4%	
2006	B+	7	57,794	38,588	31.4%	38,626	41.0%	5.4%	
2007 and later	CCC	7	31,325	19,684	16.0%	20,923	29.7%	3.5%	
Total / WA	B	63	\$ 246,014	\$ 123,023	100.0%	\$ 128,622	32.5%	4.4%	

Vintage (B)	Collateral Characteristics				
	Average Loan Age (years)	Collateral Factor (F)	3 month CPR (G)	Delinquency (H)	Cumulative Losses to Date
2003	9.0	0.09	6.2%	18.1%	4.1%
2004	7.6	0.14	9.1%	17.5%	4.1%
2005	6.6	0.18	10.9%	28.1%	11.1%
2006	5.8	0.31	12.7%	24.3%	18.6%
2007 and later	5.3	0.47	10.2%	22.9%	21.1%
Total / WA	6.5	0.24	10.7%	24.5%	12.8%

## Real Estate ABS

Asset Type	Security Characteristics							
	Average Minimum Rating (C)	Number	Outstanding Face Amount	Amortized Cost Basis	Percentage of Total Amortized Cost Basis	Carrying Value	Principal Subordination (D)	Excess Spread (E)
Manufactured Housing	BBB+	7	\$ 30,232	\$ 29,454	73.8%	\$ 30,547	41.6%	1.5%
Small Business Loans	BB+	7	23,115	10,465	26.2%	7,560	21.9%	0.8%
Total / WA	BBB-	14	\$ 53,347	\$ 39,919	100.0%	\$ 38,107	33.1%	1.2%

Asset Type	Collateral Characteristics				
	Average Loan Age (months)	Collateral Factor (F)	3 Month CPR (G)	Delinquency (H)	Cumulative Losses to Date
Manufactured Housing	12.2	0.25	6.3%	2.3%	13.4%
Small Business Loans	6.8	0.50	5.9%	21.6%	17.3%
Total / WA	9.9	0.36	6.1%	10.6%	15.1%

(A) Includes subprime retained securities in the securitizations of Subprime Portfolios I and II. For further information on these securitizations, see Note 5 to our consolidated financial statements included herein.

(B) The year in which the securities were issued.

(C) Ratings provided above were determined by third party rating agencies as of a particular date, may not be current and are subject to change at any time. We had approximately \$25.1 million of ABS securities that were on negative watch for possible downgrade by at least one rating agency as of December 31, 2011.

- (D) The percentage of the outstanding face amount of securities and residual interests that is subordinate to our investments.  
(E) The annualized amount of interest received on the underlying loans in excess of the interest paid on the securities, as a percentage of the outstanding collateral balance.  
(F) The ratio of original unpaid principal balance of loans still outstanding.  
(G) Three month average constant prepayment rate.  
(H) The percentage of underlying loans that are 90+ days delinquent, in foreclosure, or considered real estate owned.

### REIT Debt

Industry	Average Minimum Rating (A)	Number	Outstanding Face Amount	Amortized Cost Basis	Percentage of Total	
					Amortized Cost Basis	Carrying Value
Retail	A-	4	\$ 34,525	\$ 33,712	24.8%	\$ 36,406
Diversified	CCC+	4	39,286	38,502	28.3%	32,866
Office	BBB	6	34,117	34,413	25.3%	34,750
Multifamily	BBB	3	12,765	12,794	9.4%	13,429
Healthcare	BBB-	3	16,700	16,510	12.2%	17,845
<b>Total / WA</b>	<b>BB+</b>	<b>20</b>	<b>\$ 137,393</b>	<b>\$ 135,931</b>	<b>100.0%</b>	<b>\$ 135,296</b>

### Corporate Bank Loans

Industry	Average Minimum Rating (A)	Number	Outstanding Face Amount	Amortized Cost Basis	Percentage of Total	
					Amortized Cost Basis	Carrying Value
Real Estate	NR	1	\$ 17,811	\$ 15,139	9.4%	\$ 15,139
Media	CCC-	2	110,710	25,222	15.7%	25,222
Resorts	NR	1	136,156	106,156	65.9%	106,156
Restaurant	B	2	18,101	14,636	9.0%	14,636
<b>Total / WA</b>	<b>CC</b>	<b>6</b>	<b>\$ 282,778</b>	<b>\$ 161,153</b>	<b>100.0%</b>	<b>\$ 161,153</b>

- (A) Ratings provided above were determined by third party rating agencies as of a particular date, may not be current and are subject to change at any time. We had \$27.9 million of REIT debt and no corporate bank loans that were on negative watch for possible downgrade by at least one rating agency as of December 31, 2011.

### Excess MSRs

#### Collateral Characteristics:

	Collateral Characteristics										
	Initial Investment		Original Principal Balance	Current Principal Balance	WA Coupon	WA Maturity (months)	Average Loan Age (months)	Delinquency 30+ (A)	1 Month CPR (B)	1 Month CRR (C)	1 Month CDR (D)
	Amount	Carrying Amount									
Portfolio I	\$ 43,742	\$ 43,971	\$ 9,908,081	\$ 9,705,512	6.1%	288	62	7.6%	9.5%	9.4%	0.1%

- (A) The percentage of underlying loans that missed their last payment.  
(B) Constant prepayment rate.  
(C) Voluntary prepayment rate.  
(D) Involuntary prepayment rate.

### Credit Risk Management

Credit risk refers to the ability of each individual borrower under our loans and securities to make required interest and principal payments on the scheduled due dates. We strive to reduce credit risk by actively monitoring our asset portfolio and the underlying credit quality of our holdings and, where feasible and appropriate, repositioning our investments to upgrade their credit quality and yield. A significant portion of our investments are financed with collateralized debt obligations, known as CDOs. Our CDO financings offer us the structural flexibility to buy and sell certain investments to manage risk and, subject to certain limitations, to optimize returns.

Further, while the expected yield on our real estate securities, which comprise a meaningful portion of our assets, is sensitive to the performance of the underlying loans, the first risk of default and loss - referred to as a "first loss" position - is borne by the more subordinated securities or other features of the securitization transaction, in the case of commercial

mortgage and asset backed securities, and the issuer's underlying equity and subordinated debt, in the case of senior unsecured REIT debt securities. We also invest in loans and securities which represent "first loss" positions; in other words, they do not benefit from credit support although we believe at acquisition they predominantly benefit from underlying collateral value in excess of their carrying amounts.

### **Our Financing and Hedging Activities**

We employ leverage as part of our investment strategy. We do not have a predetermined target debt to equity ratio as we believe the appropriate leverage for the particular assets we are financing depends on the credit quality of those assets. As of December 31, 2011 and as of the date of this Annual Report, we have complied with the general investment guidelines adopted by our board of directors that limit total leverage. We utilize leverage for the sole purpose of financing our portfolio and not for the purpose of speculating on changes in interest rates.

We strive to maintain access to a broad array of capital resources in an effort to insulate our business from potential fluctuations in the availability of capital. We utilize multiple forms of financing, including collateralized debt obligations (CDOs), other securitizations, term loans, and trust preferred securities, as well as short term financing in the form of loans and repurchase agreements. Further details regarding the forms of financing that we are currently able to utilize are presented in Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" under "- Market Considerations" and "- Liquidity and Capital Resources."

Our manager may elect for us to bear a level of refinancing risk on a short term or longer term basis, such as is the case with investments financed with repurchase agreements, when, based on all of the relevant factors, the manager determines that bearing such risk is advisable or unavoidable.

We attempt to reduce refinancing and interest rate risks through the use of match funded financing structures, when appropriate and available, whereby we seek (i) to match the maturities of our debt obligations with the maturities of our assets and (ii) to match the interest rates on our investments with like-kind debt (i.e., floating rate assets are financed with floating rate debt and fixed rate assets are financed with fixed rate debt), directly or through the use of interest rate swaps, interest rate caps or other financial instruments, or through a combination of these strategies. We believe this allows us to reduce the risk that we have to refinance our liabilities prior to the maturities of our assets and to reduce the impact of changing interest rates on our earnings.

We have entered into hedging transactions to protect our positions from interest rate fluctuations and other changes in market conditions, and we may continue to do so, when feasible and appropriate. These transactions predominantly include interest rate swaps, interest rate caps and may include the purchase or sale of interest rate collars, caps or floors, options, mortgage derivatives and other hedging instruments, and may be subject to margin calls. These instruments may be used to hedge as much of the interest rate risk as our manager determines is in the best interest of our stockholders, given the cost of such hedges and the need to maintain our status as a REIT. Our manager elects to have us bear a level of interest rate risk that could otherwise be hedged when our manager believes, based on its analysis, that bearing such risks is advisable or unavoidable. We engage in hedging for the purpose of protecting against interest rate risk and not for the purpose of speculating on changes in interest rates. We note that new hedging transactions with respect to many types of hedging instruments may impose liquidity constraints on us or may be uneconomical for us to obtain. As a result, we currently face meaningful challenges in entering into hedging transactions to protect new investments from interest rate fluctuations and other changes in market conditions.

Further details regarding our hedging activities are presented in Part II, Item 7A, "Quantitative and Qualitative Disclosures About Market Risk – Interest Rate and Credit Spread Sensitive Instruments and Fair Value."

## Debt Obligations

The following table presents certain summary information regarding our debt obligations and related hedges as of December 31, 2011 (dollars in thousands):

	Collateral										Aggregate Notional Amount of Current Hedges (3)
	Outstanding Face Amount	Carrying Value	Weighted Average Funding Cost (1)	Weighted Average Maturity (Years)	Face Amount of Floating Rate Debt	Outstanding Face Amount (2)	Amortized Cost Basis (2)	Carrying Value (2)	Weighted Average Maturity (Years)	Floating Rate Face Amount (2)	
<b>Debt Obligation</b>											
CDO Bonds Payable	\$ 2,405,044	\$ 2,403,605	2.76%	3.7	\$ 2,383,203	\$ 3,126,824	\$ 2,353,413	\$ 2,360,015	3.8	\$ 1,145,644	\$ 1,172,612
Other Bonds and Notes Payable	202,456	200,377	4.31%	3.5	5,491	370,189	327,816	327,816	6.6	88,558	-
Repurchase Agreements (4)	239,740	239,740	0.49%	0.2	239,740	232,355	244,916	244,916	4.6	232,355	-
Junior Subordinated Notes Payable	51,004	51,248	7.41%	23.3	-	-	-	-	-	-	-
Subtotal debt obligations	2,898,244	2,894,970	2.76%	3.7	\$ 2,628,434	\$ 3,729,368	\$ 2,926,145	\$ 2,932,747	4.1	\$ 1,466,557	\$ 1,172,612
Financing on Subprime Mortgage Loans Subject to Call Option	406,217	404,723									
Total debt obligations	\$ 3,304,461	\$ 3,299,693									

(1) Including the effect of applicable hedges.

(2) Including restricted cash held for reinvestment in CDOs.

(3) Including a \$36.4 million notional amount of interest rate cap agreements in CDO X, and \$95.3 million and \$88.3 million notional amount of interest rate swap agreements in CDOs IV and VI, respectively, which were economic hedges not designated as hedges for accounting purposes.

(4) These repurchase agreements were partially secured by \$29.1 million face amount of notes issued by Newcastle CDO VI, which was repurchased by Newcastle in December 2010 and eliminated in consolidation. As of December 31, 2011, the maximum recourse to Newcastle was \$2.2 million.

Further details regarding our debt obligations are presented in “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources,” as well as Note 8 to Part II, Item 8, “Financial Statements and Supplementary Data.”

## Formation

We were formed in June 2002 and completed our initial public offering in October 2002.

The following table presents information on shares of our common stock issued since our formation:

Year	Shares Issued	Range of Issue Prices (1)	Net Proceeds (millions)
Formation - 2006	45,713,817		
2007	7,065,362	\$27.75-\$31.30	\$201.3
2008	9,871	N/A	\$0.1
2009	123,463	N/A	\$0.1
2010	9,114,671	\$3.13	\$28.5
2011	43,153,825	\$4.55 - \$6.00	\$210.8
December 31, 2011	<u>105,181,009</u>		

(1) Excludes prices of shares issued pursuant to the exercise of options and of shares issued to our independent directors. Includes prices of shares issued in exchange for preferred shares.

## Investment Guidelines

Our general investment guidelines, adopted by our board of directors, include:

- no investment is to be made which would cause us to fail to qualify as a REIT;
- no investment is to be made which would cause us to be regulated as an investment company;
- no more than 20% of our total equity, determined as of the date of such investment, is to be invested in any single asset;
- our leverage (as defined in our governing documents) is not to exceed 90% of the sum of our total debt and our total equity; and
- we are not to co-invest with the manager or any of its affiliates unless (i) our co-investment is otherwise in accordance with these guidelines and (ii) the terms of such co-investment are at least as favorable to us as to the manager or such affiliate (as applicable) making such co-investment.

In addition, our manager is required to seek the approval of the independent members of our board of directors before we engage in a material transaction with another entity managed by our manager or any of its affiliates. These investment guidelines may be changed by our board of directors without the approval of our stockholders.

## The Management Agreement

We are party to a management agreement with FIG LLC, an affiliate of Fortress Investment Group LLC, dated June 23, 2003, pursuant to which FIG LLC, our manager, provides for the day-to-day management of our operations.

The management agreement requires our manager to manage our business affairs in conformity with the policies and the investment guidelines that are approved and monitored by our board of directors. Our manager manages our operations under the direction of our board of directors. The manager is responsible for, among other things, (i) the purchase and sale of real estate securities, loans, excess MSR's and other real estate related assets, (ii) the financing of our real estate securities and loans and other real estate related assets, (iii) management of our real estate, including arranging for purchases, sales, leases, maintenance and insurance, (iv) the purchase, sale and servicing of loans for us, and (v) investment advisory services. Our manager is responsible for our day-to-day operations and performs (or causes to be performed) such services and activities relating to our assets and operations as may be appropriate.

We pay our manager an annual management fee equal to 1.5% of our gross equity, as defined in the management agreement. The management agreement provides that we will reimburse our manager for various expenses incurred by our manager or its officers, employees and agents on our behalf, including costs of legal, accounting, tax, auditing, administrative and other similar services rendered for us by providers retained by our manager or, if provided by our manager's employees, in amounts which are no greater than those which would be payable to outside professionals or consultants engaged to perform such services pursuant to agreements negotiated on an arm's-length basis.

To provide an incentive for our manager to enhance the value of our common stock, our manager is entitled to receive an incentive return (the "Incentive Compensation") on a cumulative, but not compounding, basis in an amount equal to the product of (A) 25% of the dollar amount by which (1) (a) our funds from operations (defined as the net income available

for common stockholders before the Incentive Compensation, excluding extraordinary items, plus depreciation of operating real estate, and after adjusting for unconsolidated subsidiaries, if any) per share of common stock (based on the weighted average number of shares of common stock outstanding) plus (b) gains (or losses) from debt restructuring and from sales of property and other assets per share of common stock (based on the weighted average number of shares of common stock outstanding), exceed (2) an amount equal to (a) the weighted average of the price per share of common stock in our initial public offering and the value attributed to the net assets transferred to us by Newcastle Investment Holdings, and in any of our subsequent offerings (adjusted for prior capital dividends or capital distributions) multiplied by (b) a simple interest rate of 10% per annum (divided by four to adjust for quarterly calculations) multiplied by (B) the weighted average number of shares of common stock outstanding. Our manager earned no incentive compensation during 2011, 2010, or 2009.

The management agreement provides for automatic one year extensions. Our independent directors review our manager's performance annually and the management agreement may be terminated annually upon the affirmative vote of at least two-thirds of our independent directors, or by a vote of the holders of a majority of the outstanding shares of our common stock, based upon unsatisfactory performance that is materially detrimental to us or a determination by our independent directors that the management fee earned by our manager is not fair, subject to our manager's right to prevent such a management fee compensation termination by accepting a mutually acceptable reduction of fees. Our manager must be provided with 60 days' prior notice of any such termination and would be paid a termination fee equal to the amount of the management fee earned by our manager during the twelve month period preceding such termination, which may make it difficult and costly for us to terminate the management agreement. Following any termination of the management agreement, we shall be entitled to purchase our manager's right to receive the Incentive Compensation at a price determined as if our assets were sold for cash at their then current fair market value (as determined by an appraisal, taking into account, among other things, the expected future value of the underlying investments) or otherwise we may continue to pay the Incentive Compensation to our manager. In addition, if we do not purchase our manager's Incentive Compensation, our manager may require us to purchase the same at the price discussed above. In addition, the management agreement may be terminated by us at any time for cause.

#### **Policies with Respect to Certain Other Activities**

Subject to the approval of our board of directors, we have the authority to offer our common stock or other equity or debt securities in exchange for property and to repurchase or otherwise reacquire our shares or any other securities and may engage in such activities in the future.

We also may make loans to, or provide guarantees of certain obligations of, our subsidiaries.

Subject to the percentage ownership and gross income and asset tests necessary for REIT qualification, we may invest in securities of other REITs, other entities engaged in real estate activities or securities of other issuers, including for the purpose of exercising control over such entities.

We may engage in the purchase and sale of investments.

Our officers and directors may change any of these policies and our investment guidelines without a vote of our stockholders.

In the event that we determine to raise additional equity capital, our board of directors has the authority, without stockholder approval (subject to certain NYSE requirements), to issue additional common stock or preferred stock in any manner and on such terms and for such consideration it deems appropriate, including in exchange for property.

Decisions regarding the form and other characteristics of the financing for our investments are made by our manager subject to the general investment guidelines adopted by our board of directors.

#### **Competition**

We are subject to significant competition in seeking investments. We compete with several other companies for investments, including other REITs, mortgage servicers, insurance companies and other investors. Some of our competitors have advantages over us, such as greater resources than we possess, or greater access to capital or various types of financing than are available to us, and we may not be able to compete successfully for investments. See Part 1, Item 1A, "Risk Factors – We are subject to significant competition, and we may not compete successfully."

## **Compliance with Applicable Environmental Laws**

Properties we own (directly or indirectly) or may acquire are or would be subject to various foreign, federal, state and local environmental laws, ordinances and regulations. Under these laws, ordinances and regulations, a current or previous owner of real estate (including, in certain circumstances, a secured lender that succeeds to ownership or control of a property) may become liable for the costs of removal or remediation of certain hazardous or toxic substances or petroleum product released at, on, under or in its property. These laws typically impose cleanup responsibility and liability without regard to whether the owner or control party knew of or was responsible for the release or presence of the hazardous or toxic substances. The costs of investigation, remediation or removal of these substances may be substantial and could exceed the value of the property. An owner or control party of a site may be subject to common law claims by third parties based on damages and costs resulting from environmental contamination emanating from a site. Certain environmental laws also impose liability in connection with the handling of or exposure to asbestos-containing materials, pursuant to which third parties may seek recovery from owners of real properties for personal injuries associated with asbestos-containing materials. Our operating costs and values of these assets may be adversely affected by the obligation to pay for the cost of complying with existing environmental laws, ordinances and regulations, as well as the cost of complying with future legislation, and our income and ability to make distributions to our stockholders could be affected adversely by the existence of an environmental liability with respect to our properties. We endeavor to ensure that properties we own or acquire will be in compliance in all material respects with all foreign, federal, state and local laws, ordinances and regulations regarding hazardous or toxic substances or petroleum products.

## **Employees**

As described above under “– The Management Agreement,” we are managed by FIG LLC, an affiliate of Fortress Investment Group LLC. As a result, we have no employees. From time to time, certain of our officers may enter into written agreements with us that memorialize the provision of certain services; these agreements do not provide for the payment of any cash compensation to such officers from us. The employees of FIG LLC are not a party to any collective bargaining agreement.

## **Corporate Governance and Internet Address; Where Readers Can Find Additional Information**

We emphasize the importance of professional business conduct and ethics through our corporate governance initiatives. Our board of directors consists of a majority of independent directors; the Audit, Nominating and Corporate Governance, and Compensation committees of our board of directors are composed exclusively of independent directors. We have adopted corporate governance guidelines, and our manager has adopted a code of business conduct and ethics, which delineate our standards for our officers and directors, and employees of our manager.

Newcastle files annual, quarterly and current reports, proxy statements and other information required by the Securities Exchange Act of 1934, as amended (the “Exchange Act”), with the Securities and Exchange Commission (“SEC”). Readers may read and copy any document that Newcastle files at the SEC’s Public Reference Room located at 100 F Street, N.E., Washington, D.C. 20549, U.S.A. Please call the SEC at 1-800-SEC-0330 for further information on the Public Reference Room. Our SEC filings are also available to the public from the SEC’s internet site at <http://www.sec.gov>. Copies of these reports, proxy statements and other information can also be inspected at the offices of the New York Stock Exchange, Inc., 20 Broad Street, New York, New York 10005, U.S.A.

Our internet site is <http://www.newcastleinv.com>. We make available free of charge through our internet site our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy statements and Forms 3, 4 and 5 filed on behalf of directors and executive officers and any amendments to those reports filed or furnished pursuant to the Exchange Act as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. Also posted on our website in the “Investor Relations—Corporate Governance” section are charters for the company’s Audit Committee, Compensation Committee and Nominating and Corporate Governance Committee as well as our Corporate Governance Guidelines and our Code of Business Conduct and Ethics governing our directors, officers and employees. Information on, or accessible through, our website is not a part of, and is not incorporated into, this report.

## **Item 1A. Risk Factors**

Risks relating to our management, business and company include, specifically:

### *Risks Related to the Financial Markets*

#### **We do not know what impact the Dodd-Frank Act will have on our business.**

On July 21, 2010, the United States enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act” or “Act”). The Dodd-Frank Act affects almost every aspect of the U.S. financial services industry, including certain aspects of the markets in which we operate. The Act imposes new regulations on us and how we conduct our business. For example, the Act will impose additional disclosure requirements for public companies and generally require issuers or originators of asset-backed securities to retain at least five percent of the credit risk associated with the securitized assets. In addition, as a result of the Act, we were required to register as an investment adviser with the SEC, which increases our regulatory compliance costs and subjects us to the Investment Advisers Act of 1940, as amended (the “Advisers Act”). The Advisers Act imposes numerous obligations on registered investment advisers, including record-keeping, reporting, operational and marketing requirements, disclosure obligations and prohibitions on fraudulent activities. The SEC is authorized to institute proceedings and impose sanctions for violations of the Advisers Act, ranging from fines and censure to termination of an investment adviser’s registration. Investment advisers also are subject to certain state securities laws and regulations. Non-compliance with the Advisers Act or other federal and state securities laws and regulations could result in investigations, sanctions, disgorgement, fines and reputational damage.

The Act will impose mandatory clearing, exchange-trading and margin requirements on many derivatives transactions (including formerly unregulated over-the-counter derivatives) in which we may engage. The Act also creates new categories of regulated market participants, such as “swap-dealers,” “security-based swap dealers,” “major swap participants” and “major security-based swap participants,” who will be subject to significant new capital, registration, recordkeeping, reporting, disclosure, business conduct and other regulatory requirements that will give rise to new administrative costs. In addition, the new regulation of over-the-counter derivatives and a recently-adopted implementing rule may require us to register with and be regulated by the U.S. Commodity Futures Trading Commission (“CFTC”) as a commodity pool operator (“CPO”). The Commodity Exchange Act and CFTC regulations impose various requirements on CPOs, including record-keeping, reporting, operational and marketing requirements, disclosure obligations and prohibitions on fraudulent activities. Complying with these requirements could increase our expenses and negatively impact our financial results.

Even if certain new requirements are not directly applicable to us, they may still increase our costs of entering into transactions with the parties to whom the requirements are directly applicable. Moreover, new exchange-trading and trade reporting requirements may lead to reductions in the liquidity of derivative transactions, causing higher pricing or reduced availability of derivatives, or the reduction of arbitrage opportunities for us, which could adversely affect the performance of certain of our trading strategies. Importantly, many key aspects of the changes imposed by the Act will be established by various regulatory bodies and other groups over the next several years. As a result, we do not know how significantly the Act will affect us. It is possible that the Act could, among other things, increase our costs of operating as a public company, impose restrictions on our ability to securitize assets and reduce our investment returns on securitized assets.

#### **We do not know what impact certain U.S. government programs intended to stabilize the economy and the financial markets will have on our business.**

In recent years, the U.S. government has taken a number of steps to attempt to strengthen the financial markets and U.S. economy, including direct government investments in, and guarantees of, troubled financial institutions as well as government-sponsored programs such as the Term Asset-Backed Securities Loan Facility program (TALF) and the Public Private Investment Partnership Program (PPIP). The U.S. government continues to evaluate or implement an array of other measures and programs intended to help improve U.S. financial and market conditions. While conditions appear to have improved relative to the depths of the global financial crisis, it is not clear whether this improvement is real or will last for a significant period of time. It is not clear what impact the government’s future actions to improve financial and market conditions will have on our business. To date, we have not benefited in a direct, material way from any government programs, and we may not derive any meaningful benefit from these programs in the future. Moreover, if any of our competitors are able to benefit from one or more of these initiatives, they may gain a significant competitive advantage over us.

**Legislation that permits modifications to the terms of outstanding loans has negatively affected our business, financial condition and results of operations.**

The U.S. government has enacted legislation that enables government agencies to modify the terms of a significant number of residential and other loans to provide relief to borrowers without the applicable investor's consent. These modifications allow for outstanding principal to be deferred, interest rates to be reduced, the length of the loan to be extended or other terms to be changed in ways that can permanently eliminate the cash flow (principal and interest) associated with a portion of the loan. These modifications are currently reducing, or in the future may reduce, the value of a number of our current or future investments, including investments in mortgage-backed securities, mortgage servicing rights ("MSRs") and excess mortgage servicing rights ("excess MSRs"). As a result, such loan modifications are negatively affecting our business, results of operations and financial condition. In addition, certain market participants propose reducing the amount of paperwork required by a borrower to modify a loan, which could increase the likelihood of fraudulent modifications and materially harm the U.S. mortgage market and investors that have exposure to this market. Additional legislation intended to provide relief to borrowers may be enacted and could further harm our business, results of operations and financial condition.

*Risks Relating to Our Management*

**We are dependent on our manager and may not find a suitable replacement if our manager terminates the management agreement.**

We have no employees. Our officers and other individuals who perform services for us are employees of our manager. We are completely reliant on our manager, which has significant discretion as to the implementation of our operating policies and strategies, to conduct our business. We are subject to the risk that our manager will terminate the management agreement and that we will not be able to find a suitable replacement for our manager in a timely manner, at a reasonable cost or at all. Furthermore, we are dependent on the services of certain key employees of our manager whose compensation is partially or entirely dependent upon the amount of incentive or management compensation earned by our manager and whose continued service is not guaranteed, and the loss of such services could adversely affect our operations.

**There are conflicts of interest in our relationship with our manager.**

Our chairman serves as an officer of our manager. Our management agreement with our manager was not negotiated at arm's-length, and its terms, including fees payable, may not be as favorable to us as if it had been negotiated with an unaffiliated third party.

There are conflicts of interest inherent in our relationship with our manager insofar as our manager and its affiliates — including investment funds, private investment funds, or businesses managed by our manager — invest in real estate securities, real estate related loans and operating real estate and whose investment objectives overlap with our investment objectives. Certain investments appropriate for us may also be appropriate for one or more of these other investment vehicles. Members of our board of directors and employees of our manager who are our officers may serve as officers and/or directors of these other entities. In addition, our manager or its affiliates may have investments in and/or earn fees from such other investment vehicles that are higher than their economic interests in us and which may therefore create an incentive to allocate investments to such other investment vehicles. Our manager or its affiliates may determine, in their discretion, to make a particular investment through another investment vehicle rather than through us and have no obligation to offer to us the opportunity to participate in any particular investment opportunity. Accordingly, it is possible that we may not be given the opportunity to participate at all in certain investments made by our affiliates that meet our investment objectives.

Our management agreement with our manager generally does not limit or restrict our manager or its affiliates from engaging in any business or managing other pooled investment vehicles that invest in investments that meet our investment objectives, except that under our management agreement neither our manager nor any entity controlled by or under common control with our manager is permitted to raise or sponsor any new pooled investment vehicle whose investment policies, guidelines or plan target as its primary investment category investment in U.S. dollar-denominated credit sensitive real estate related securities reflecting primarily U.S. loans or assets. Our manager intends to engage in additional real estate related management and investment opportunities in the future, which may compete with us for investments.

The ability of our manager and its officers and employees to engage in other business activities, subject to the terms of our management agreement with our manager, may reduce the amount of time our manager, its officers or other employees spend managing us. In addition, we may engage (subject to our investment guidelines) in material transactions with our manager or another entity managed by our manager or one of its affiliates, including certain financing arrangements and co-investments, investments in excess MSRs and senior living facilities, that present an actual, potential or perceived conflict of interest. It is possible that actual, potential or perceived conflicts could give rise to investor dissatisfaction,

litigation or regulatory enforcement actions. Appropriately dealing with conflicts of interest is complex and difficult, and our reputation could be damaged if we fail, or appear to fail, to deal appropriately with one or more potential, actual or perceived conflicts of interest. Regulatory scrutiny of, or litigation in connection with, conflicts of interest could have a material adverse effect on our reputation, which could materially adversely affect our business in a number of ways, including causing an inability to raise additional funds, a reluctance of counterparties to do business with us, a decrease in the prices of our common and preferred securities and a resulting increased risk of litigation and regulatory enforcement actions.

The management compensation structure that we have agreed to with our manager, as well as compensation arrangements that we may enter into with our manager in the future (in connection with new lines of business or other activities), may incentivize our manager to invest in high risk investments. In addition to its management fee, our manager is currently entitled to receive incentive compensation based in part upon our achievement of targeted levels of funds from operations (as defined in the management agreement). In evaluating investments and other management strategies, the opportunity to earn incentive compensation based on funds from operations or, in the case of any future incentive compensation arrangement, other financial measures on which incentive compensation may be based, may lead our manager to place undue emphasis on the maximization of such measures at the expense of other criteria, such as preservation of capital, in order to achieve higher incentive compensation, particularly in light of the fact that our manager has not received any incentive compensation since 2008. Investments with higher yield potential are generally riskier or more speculative than lower-yielding investments. Moreover, because our manager receives compensation in the form of options in connection with the completion of our common equity offerings, our manager may be incentivized to cause us to issue additional common stock, which could be dilutive to existing shareholders.

**It would be difficult and costly to terminate our management agreement with our manager.**

It would be difficult and costly for us to terminate our management agreement with our manager. The management agreement may only be terminated annually upon the affirmative vote of at least two-thirds of our independent directors, or by a vote of the holders of a majority of the outstanding shares of our common stock, based upon (1) unsatisfactory performance by our manager that is materially detrimental to us or (2) a determination that the management fee payable to our manager is not fair, subject to our manager's right to prevent such a termination by accepting a mutually acceptable reduction of fees. Our manager will be provided 60 days' prior notice of any termination and will be paid a termination fee equal to the amount of the management fee earned by the manager during the twelve-month period preceding such termination. In addition, following any termination of the management agreement, the manager may require us to purchase its right to receive incentive compensation at a price determined as if our assets were sold for their fair market value (as determined by an appraisal, taking into account, among other things, the expected future value of the underlying investments) or otherwise we may continue to pay the incentive compensation to our manager. These provisions may increase the effective cost to us of terminating the management agreement, thereby adversely affecting our ability to terminate our manager without cause.

**Our directors have approved very broad investment guidelines for our manager and do not approve each investment decision made by our manager.**

Our manager is authorized to follow very broad investment guidelines. Consequently, our manager has great latitude in determining the types of assets it may decide are proper investments for us. Our directors periodically review our investment guidelines and our investment portfolio. However, our board does not review or pre-approve each proposed investment or our related financing arrangements. In addition, in conducting periodic reviews, the directors rely primarily on information provided to them by our manager. Furthermore, transactions entered into by our manager may be difficult or impossible to unwind by the time they are reviewed by the directors even if the transactions contravene the terms of the management agreement.

**We may change our investment strategy without stockholder consent, which may result in our making investments that entail more risk than our current investments.**

Our investment strategy may evolve in light of existing market conditions and investment opportunities, and this evolution may involve additional risks depending upon the nature of the assets in which we invest and our ability to finance such assets on a short or long-term basis. Investment opportunities that present unattractive risk-return profiles relative to other available investment opportunities under particular market conditions may become relatively attractive under changed market conditions and changes in market conditions may therefore result in changes in the investments we target. Decisions to make investments in new asset categories present risks that may be difficult for us to adequately assess and could therefore reduce our ability to pay dividends on both our common stock and preferred stock or have adverse effects on our liquidity or financial condition. A change in our investment strategy may also increase our exposure to interest rate, foreign currency, real estate market or credit market fluctuations. In addition, a change in our investment strategy may increase our use of non-match-funded financing, increase the guarantee obligations we agree to incur or increase the number of transactions we enter into with affiliates. Our failure to accurately assess the risks inherent in new asset

categories or the financing risks associated with such assets could adversely affect our results of operations and our financial condition.

**We are actively exploring new business opportunities, which may be unsuccessful, divert managerial attention or require significant financial resources, which could have a negative impact on our financial results.**

Consistent with our broad investment guidelines and our investment objectives, we have acquired and are actively exploring additional opportunities to acquire excess MSR and additional classes of operating real estate, including senior living facilities. See “—We invest in excess MSR, and such investments could have a negative impact on our financial results,” and “—We may invest in senior living facilities, which are subject to various risks that could have a negative impact on our financial results.”

Although we currently believe that we will have significant opportunities to acquire such assets in the future, these opportunities may not materialize. We also believe investing in such assets will provide us attractive risk-adjusted returns, but, assuming we are successful in acquiring these assets, they may not achieve the returns we anticipate and may not even be profitable. Moreover, these investments may not be successful, given that we do not have significant experience in owning these types of assets, or for other reasons. Further, these new business opportunities may divert managerial attention from more profitable opportunities, and they may require significant financial resources. Any or all of the foregoing could have a negative impact on our financial results.

#### *Risks Relating to Our Business*

**Market conditions could negatively impact our business, results of operations and financial condition.**

The market in which we operate is affected by a number of factors that are largely beyond our control but can nonetheless have a potentially significant, negative impact on us. These factors include, among other things:

- Interest rates and credit spreads;
- The availability of credit, including the price, terms and conditions under which it can be obtained;
- The quality, pricing and availability of suitable investments and credit losses with respect to our investments;
- The ability to obtain accurate market-based valuations;
- Loan values relative to the value of the underlying real estate assets;
- Default rates on both commercial and residential mortgages and the amount of the related losses;
- Prepayment speeds, delinquency rates and legislative/regulatory changes with respect to our investments in excess MSR;
- The actual and perceived state of the real estate markets, market for dividend-paying stocks and public capital markets generally;
- Unemployment rates; and
- The attractiveness of other types of investments relative to investments in real estate or REITs generally.

Changes in these factors are difficult to predict, and a change in one factor can affect other factors. For example, during 2007, increased default rates in the subprime mortgage market played a role in causing credit spreads to widen, reducing availability of credit on favorable terms, reducing liquidity and price transparency of real estate related assets, resulting in difficulty in obtaining accurate mark-to-market valuations, and causing a negative perception of the state of the real estate markets and of REITs generally. These conditions worsened during 2008, and intensified meaningfully during the fourth quarter of 2008 as a result of the global credit and liquidity crisis, resulting in extraordinarily challenging market conditions. Since then, market conditions have generally improved, but they could deteriorate in the future.

**A prolonged economic slowdown, a lengthy or severe recession, or declining real estate values could harm our operations.**

We believe the risks associated with our business are more severe during periods similar to those we recently experienced in which an economic slowdown or recession is accompanied by declining real estate values. Declining real estate values generally reduce the level of new mortgage loan originations, since borrowers often use increases in the value of their existing properties to support the purchase of, or investment in, additional properties. Borrowers may also be less able to pay principal and interest on our loans, and the loans underlying our securities, if the real estate economy weakens. Further, declining real estate values significantly increase the likelihood that we will incur losses on our loans and securities in the event of default because the value of our collateral may be insufficient to cover our basis. Any sustained period of increased payment delinquencies, foreclosures or losses could adversely affect our net interest income from loans and securities in our portfolio and our income from excess mortgage servicing rights, as well as our ability to originate, sell and securitize loans, which would significantly harm our revenues, results of operations, financial condition, liquidity, business prospects and our ability to make distributions to our shareholders. For more information on the impact of market

conditions on our business and results of operations see Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Market Considerations.”

**The coverage tests applicable to our CDO financings may have a negative impact on our operating results and cash flows.**

We have retained, and may in the future retain or repurchase, subordinate classes of bonds issued by certain of our subsidiaries in our CDO financings. Each of our CDO financings contains tests that measure the amount of over collateralization and excess interest in the transaction. Failure to satisfy these tests would generally result in principal and/or interest cash flow that would otherwise be distributed to more junior classes of securities (including those held by us) to be redirected to pay down the most senior class of securities outstanding until the tests are satisfied. As a result, failure to satisfy the coverage tests could adversely affect our operating results and cash flows by temporarily or permanently directing funds that would otherwise come to us to holders of the senior classes of bonds. In addition, the redirected funds would be used to pay down financing, which currently bears an attractive rate, thereby reducing our future earnings from the affected CDO. The ratings assigned to the assets in each CDO affect the results of the tests governing whether a CDO can distribute cash to the various classes of securities in the CDO. As a result, ratings downgrades of the assets in a CDO can result in a CDO failing its tests and thereby cause us not to receive cash flows from the affected CDO.

We had approximately \$128.2 million of assets in our consolidated CDOs as of December 2011 or February 2012, as appropriate, that are under negative watch for possible downgrade by at least one of the rating agencies. One or more of the rating agencies could downgrade some or all of these assets at any time, and any such downgrade could negatively affect – and possibly materially affect – our future cash flows. As of the December 2011 remittance date for CDO IV and as of the February 2012 remittance date for CDO VI, these CDOs were not in compliance with their applicable over collateralization tests and, consequently, we are not receiving residual cash flows from these CDOs. However, we continue to receive senior management fees and cash flow distributions from senior classes of bonds we own. Based upon our current calculations, we expect these CDOs to remain out of compliance for the foreseeable future. Moreover, given current market conditions, it is possible that all of our CDOs could be out of compliance with their over collateralization tests as of one or more measurement dates within the next twelve months.

Our ability to rebalance will depend upon the availability of suitable securities, market prices, whether the reinvestment period of the applicable CDO has ended, and other factors that are beyond our control. For example, one strategy we have employed to facilitate compliance with over collateralization tests has been to repurchase notes issued by our CDOs and subsequently cancel them in accordance with the terms of the relevant governing documentation. However, there can be no assurance that the trustee of our CDOs will not impose guidelines for such cancelations that would make it more difficult or impossible to employ this strategy in the future. While there are other permissible methods to rebalance or otherwise correct CDO test failures, such methods may be extremely difficult to employ given current market conditions, and we cannot assure you that we will be successful in our rebalancing efforts. If the liabilities of our CDOs are downgraded by Moody’s Investors Service to certain predetermined levels, our discretion to rebalance the applicable CDO portfolios may be negatively impacted. Moreover, if we bring these coverage tests into compliance, we cannot assure you that they will not fall out of compliance in the future or that we will be able to correct any noncompliance.

Failure of the over collateralization tests can also cause a “phantom income” issue if cash that constitutes income is diverted to pay down debt instead of distributed to us. For more information regarding noncompliance with the terms of certain of our CDO financings in the near future, please see Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations–Liquidity and Capital Resources” and “–Debt Obligations.”

**We may experience an event of default or be removed as collateral manager under one or more of our CDOs, which would negatively affect us in a number of ways.**

The documentation governing our CDOs specifies certain events of default, which, if they occur, would negatively affect us. Events of default include, among other things, failure to pay interest on senior classes of securities within the CDO, breaches of covenants, representations or warranties, bankruptcy, and failure to satisfy specific over collateralization and interest coverage tests. If an event of default occurs under any of our CDOs, it could negatively affect our cash flows, business, results of operations and financial condition.

In addition, we can be removed as manager of a CDO if certain events occur, including the failure to satisfy specific over collateralization and interest coverage tests, failure to satisfy certain “key man” requirements or an event of default occurring for the failure to pay interest on the related senior classes of securities of the CDO. If we are removed as collateral manager, we would no longer receive management fees from — and no longer be able to manage the assets of — the applicable CDO, which could negatively affect our cash flows, business, results of operations and financial condition. On June 17, 2011, CDO V failed additional over collateralization tests. The consequences of failing these tests are that an event of default has occurred, and we may be removed as the collateral manager under the documentation governing CDO

V. So long as the event of default continues, we will not be permitted to purchase or sell any collateral in CDO V. If we are removed as the collateral manager of CDO V, we would no longer receive the senior management fees from such CDO. As of February 29, 2012, we have not been removed as collateral manager. Based upon our current calculations, we estimate that if we are removed as the collateral manager of CDO V, the loss of senior management fees would not have a material negative impact on our cash flows, business, results of operations or financial condition. Given current market conditions, it is possible that events of default may occur in other CDOs, and we could be removed as the collateral manager of those CDOs if certain events of default occur. Moreover, our cash flows, business, results of operations and/or financial condition could be materially and negatively impacted if certain events of default occur.

**We have assumed the role of manager of numerous CDOs previously managed by a third party, and we may assume the role of manager of additional CDOs in the future. Each such engagement exposes us to a number of potential risks.**

Changes within our industry may result in CDO collateral managers being replaced. In such instances, we may seek to be engaged as the collateral manager of CDOs currently managed by third parties. For example, in February 2011, one of our subsidiaries became the collateral manager of certain CDOs previously managed by C-BASS Investment Management LLC (“C-BASS”).

While being engaged as the collateral manager of such CDOs potentially enables us to grow our business, it also entails a number of risks that could harm our reputation, results of operations and financial condition. For example, we purchased the management rights with respect to the C-BASS CDOs pursuant to a bankruptcy proceeding. As a result, we were not able to conduct extensive due diligence on the CDO assets even though many classes of securities issued by the CDOs were rated as “distressed” by the rating agencies as of the most recent rating date prior to our becoming the collateral manager of the CDOs. We may willingly or unknowingly assume actual or contingent liabilities for significant expenses, we may become subject to new laws and regulations with which we are not familiar, and we may become subject to increased risk of litigation, regulatory investigation or negative publicity. For example, we determined that it would be prudent to register the subsidiary that became the collateral manager of the C-BASS CDOs as a registered investment adviser, which has increased our regulatory compliance costs. In addition to defending against litigation and complying with regulatory requirements, being engaged as collateral manager may require us to invest other resources for various other reasons, which could detract from our ability to capitalize on future opportunities. Moreover, being engaged as collateral manager may require us to integrate complex technological, accounting and management systems, which may be difficult, expensive and time-consuming and which we may not be successful in integrating into our current systems. In addition to the risk that we face if we are successful in becoming the manager of additional CDOs, we may attempt but fail to become the collateral manager of CDOs in the future, which could harm our reputation and subject us to costly litigation. Finally, if we include the financial performance of the C-BASS CDOs or other CDOs for which we become the collateral manager in our public filings, we are subject to the risk that, particularly during the period immediately after we become the collateral manager, this information may prove to be inaccurate or incomplete. The occurrence of any of these negative integration events could negatively impact our reputation with both regulators and investors, which could, in turn, subject us to additional regulatory scrutiny and impair our relationships with the investment community. The occurrence of any of these problems could negatively affect our reputation, financial condition and results of operations.

**Our investments have previously been — and in the future may be — subject to significant impairment charges, which adversely affect our results of operations.**

We are required to periodically evaluate our investments for impairment indicators. The value of an investment is impaired when our analysis indicates that, with respect to a loan, it is probable that we will not be able to collect the full amount we intended to collect from the loan or, with respect to a security, it is probable that the value of the security is other than temporarily impaired. The judgment regarding the existence of impairment indicators is based on a variety of factors depending upon the nature of the investment and the manner in which the income related to such investment was calculated for purposes of our financial statements. If we determine that an impairment has occurred, we are required to make an adjustment to the net carrying value of the investment, which could adversely affect our results of operations in the applicable period and thereby adversely affect our ability to pay dividends to our stockholders.

As has been widely publicized, the recent market conditions have resulted in a number of financial institutions recording an unprecedented amount of impairment charges, and we were also affected by these conditions. These challenging conditions have reduced the market trading activity for many real estate securities, resulting in less liquid markets for those securities. These lower valuations have affected us by, among other things, decreasing our net book value and contributing to our decision to record impairment charges.

**The lenders under our repurchase agreements may elect not to extend financing to us, which could quickly and seriously impair our liquidity.**

We have historically financed a meaningful portion of our investments not held in CDOs with repurchase agreements, which are short-term financing arrangements, and we may enter into additional repurchase agreements in the future. Under the terms of these agreements, we sell a security to a counterparty for a specified price and concurrently agree to repurchase the same security from our counterparty at a later date for a higher specified price. During the term of the repurchase agreement – generally 30 days – the counterparty makes funds available to us and holds the security as collateral. Our counterparties can also require us to post additional margin as collateral at any time during the term of the agreement. When the term of a repurchase agreement ends, we are required to repurchase the security for the specified repurchase price, with the difference between the sale and repurchase prices serving as the equivalent of paying interest to the counterparty in return for extending financing to us. If we want to continue to finance the security with a repurchase agreement, we ask the counterparty to extend – or “roll” – the repurchase agreement for another term.

Our counterparties are not required to roll our repurchase agreements upon the expiration of their stated terms, which subjects us to a number of risks. As we have experienced recently and may experience in the future, counterparties electing to roll our repurchase agreements may charge higher spread and impose more onerous terms upon us, including the requirement that we post additional margin as collateral. More significantly, if a repurchase agreement counterparty elects not to extend our financing, we would be required to pay the counterparty the full repurchase price on the maturity date and find an alternate source of financing. Alternate sources of financing may be more expensive, contain more onerous terms or simply may not be available. If we were unable to pay the repurchase price for any security financed with a repurchase agreement, the counterparty has the right to sell the underlying security being held as collateral and require us to compensate for any shortfall between the value of our obligation to the counterparty and the amount for which the collateral was sold (which may be a significantly discounted price). As of December 31, 2011, we had \$239.7 million outstanding under repurchase agreement financings. Moreover, all of our repurchase agreement obligations are with two counterparties. If any of our counterparties elected not to roll these repurchase agreements, we may not be able to find a replacement counterparty in a timely manner.

**Our determination of how much leverage to apply to our investments may adversely affect our return on our investments and may reduce cash available for distribution.**

We leverage our portfolio through borrowings, generally through the use of credit facilities, warehouse facilities, repurchase agreements, mortgage loans on real estate, securitizations, including the issuance of CDOs, private or public offerings of debt by subsidiaries, loans to entities in which we hold, directly or indirectly, interests in pools of properties or loans, and other borrowings. Our investment policies do not limit the amount of leverage we may incur with respect to any specific asset or pool of assets, subject to an overall limit on our use of leverage to 90% (as defined in our governing documents) of the value of our assets on an aggregate basis. During the recent financial crisis, the return we were able to earn on our investments and cash available for distribution to our stockholders was significantly reduced due to changes in market conditions causing the cost of our financing to increase relative to the income that can be derived from our assets. While our liquidity position has improved, we cannot assure you that we will be able to sustain our improved liquidity position.

**We may become party to agreements that require cash payments at periodic intervals. Failure to make such required payments may adversely affect our business, financial condition and results of operations.**

We are currently party to repurchase agreements that may require us to post additional margin as collateral at any time during the term of the agreement, based on the value of the collateral. We may become party to additional financing agreements that require us to make cash payments at periodic intervals or upon the occurrence of certain events. Events could occur or circumstances could arise, which we may not be able to foresee, that may cause us to be unable to make any such cash payments when they become due. Failure to make the payments required under our financing documents would give the lenders the right to require us to repay all amounts owed to them under the applicable financing immediately.

**We are subject to counterparty default and concentration risks.**

In the ordinary course of our business, we enter into various types of financing arrangements with counterparties. Currently, the majority of our financing arrangements take the form of repurchase agreements, securitization vehicles, loans, hedge contracts, swaps and other derivative and non-derivative contracts. The terms of these contracts are often customized and complex, and many of these arrangements occur in markets or relate to products that are not subject to regulatory oversight.

We are subject to the risk that the counterparty to one or more of these contracts defaults, either voluntarily or involuntarily, on its performance under the contract. Any such default may occur rapidly and without notice to us. Moreover, if a

counterparty defaults, we may be unable to take action to cover our exposure, either because we lack the contractual ability or because market conditions make it difficult to take effective action. This inability could occur in times of market stress consistent with the conditions we are currently experiencing, which are precisely the times when defaults may be most likely to occur.

In addition, our risk-management processes may not accurately anticipate the impact of market stress or counterparty financial condition, and as a result, we may not take sufficient action to reduce our risks effectively. Although we monitor our credit exposures, default risk may arise from events or circumstances that are difficult to detect, foresee or evaluate. In addition, concerns about, or a default by, one large participant could lead to significant liquidity problems for other participants, which may in turn expose us to significant losses.

In the event of a counterparty default, particularly a default by a major investment bank, we could incur material losses rapidly, and the resulting market impact of a major counterparty default could seriously harm our business, results of operations and financial condition. In the event that one of our counterparties becomes insolvent or files for bankruptcy, our ability to eventually recover any losses suffered as a result of that counterparty's default may be limited by the liquidity of the counterparty or the applicable legal regime governing the bankruptcy proceeding.

In addition, with respect to our CDOs, certain of our derivative counterparties are required to maintain certain ratings to avoid having to post collateral or transfer the derivative to another counterparty. If a counterparty was downgraded below these levels, it may not be able to satisfy its obligations under the derivative, which could have a material negative effect on the applicable CDO.

Furthermore, with respect to our investments in excess MSR, we are subject to the risks of the mortgage servicer. To the extent that it is terminated as the mortgage servicer of the underlying mortgage loan pool, or files for bankruptcy, our ability to receive excess mortgage servicing fees or eventually recover our investment would be severely impacted. See “— We will be dependent on mortgage servicers to service the mortgage loans underlying any mortgage servicing rights that we acquire.”

The counterparty risks that we face have increased in complexity and magnitude as a result of the insolvency of a number of major financial institutions (such as Bear Stearns and Lehman Brothers). For example, the consolidation and elimination of counterparties has increased our concentration of counterparty risk and decreased the universe of potential counterparties. We are currently party to repurchase agreements with two counterparties. If any of our counterparties elected not to roll these repurchase agreements, we may not be able to find a replacement counterparty. In addition, counterparties have generally tightened their underwriting standards and increased their margin requirements for financing, which has negatively impacted us in several ways, including, decreasing the number of counterparties willing to provide financing to us, decreasing the overall amount of leverage available to us, and increasing the costs of borrowing.

We are not restricted from dealing with any particular counterparty or from concentrating any or all of our transactions with a few counterparties. Any loss suffered by us as a result of a counterparty defaulting, refusing to conduct business with us or imposing more onerous terms on us would also negatively affect our business, results of operations and financial condition.

**We may not match fund certain of our investments, which may increase the risks associated with these investments.**

One component of our investment strategy is to use match funded financing structures for our investments, which match assets and liabilities with respect to maturities and interest rates. When available, this strategy mitigates the risk of not being able to refinance an investment on favorable terms or at all. However, our manager may elect for us to bear a level of refinancing risk on a short-term or longer-term basis, as in the case of investments financed with repurchase agreements, when, based on its analysis, our manager determines that bearing such risk is advisable or unavoidable (which is generally the case with respect to the residential mortgage loans and FNMA/FHLMC securities in which we invest). In addition, we may be unable, as a result of conditions in the credit markets, to match fund our investments. For example, non-recourse term financing not subject to margin requirements was generally not available or economical for the past three years and is currently still difficult to obtain, which impairs our ability to match fund our investments. Moreover, we may not be able to enter into interest rate swaps. A decision not to, or the inability to, match fund certain investments exposes us to additional risks.

Furthermore, we anticipate that, in most cases, for any period during which our floating rate assets are not match funded with respect to maturity, the income from such assets may respond more slowly to interest rate fluctuations than the cost of our borrowings. Because of this dynamic, interest income from such investments may rise more slowly than the related interest expense, with a consequent decrease in our net income. Interest rate fluctuations resulting in our interest expense exceeding interest income would result in operating losses for us from these investments.

Accordingly, if we do not or are unable to match fund our investments with respect to maturities and interest rates, we will be exposed to the risk that we may not be able to finance or refinance our investments on economically favorable terms or may have to liquidate assets at a loss.

**We may not be able to finance our investments on a long-term basis on attractive terms, including by means of securitization, which may require us to seek more costly financing for our investments or to liquidate assets.**

When we acquire securities and loans that we finance on a short-term basis with a view to securitization or other long-term financing, we bear the risk of being unable to securitize the assets or otherwise finance them on a long-term basis at attractive prices or in a timely matter, or at all. If it is not possible or economical for us to securitize or otherwise finance such assets on a long-term basis, we may be unable to pay down our short-term credit facilities, or be required to liquidate the assets at a loss in order to do so. For example, our ability to finance investments with securitizations or other long-term non-recourse financing not subject to margin requirements has been impaired since 2007 as a result of recent market conditions. These conditions make it highly likely that we will have to use less efficient forms of financing for any new investments, which will likely require a larger portion of our cash flows to be put toward making the initial investment and thereby reduce the amount of cash available for distribution to our stockholders and funds available for operations and investments, and which will also likely require us to assume higher levels of risk when financing our investments.

**The loans we invest in and the loans underlying the securities we invest in are subject to delinquency, foreclosure and loss, which could result in losses to us.**

Commercial mortgage loans are secured by multifamily or commercial property and are subject to risks of delinquency and foreclosure, and risks of loss. The ability of a borrower to repay a loan secured by an income-producing property typically is dependent primarily upon the successful operation of such property rather than upon the existence of independent income or assets of the borrower. If the net operating income of the property is reduced, the borrower's ability to repay the loan may be impaired. Net operating income of an income-producing property can be affected by, among other things: tenant mix, success of tenant businesses, property management decisions, property location and condition, competition from comparable types of properties, changes in laws that increase operating expense or limit rents that may be charged, any need to address environmental contamination at the property, the occurrence of any uninsured casualty at the property, changes in national, regional or local economic conditions and/or specific industry segments, declines in regional or local real estate values, declines in regional or local rental or occupancy rates, increases in interest rates, changes in the availability of credit on favorable terms, real estate tax rates and other operating expenses, changes in governmental rules, regulations and fiscal policies, including environmental legislation, acts of God, terrorism, social unrest and civil disturbances.

Residential mortgage loans, manufactured housing loans and subprime mortgage loans are secured by single-family residential property and are also subject to risks of delinquency and foreclosure, and risks of loss. The ability of a borrower to repay a loan secured by a residential property is dependent upon the income or assets of the borrower. A number of factors may impair borrowers' abilities to repay their loans, including, among other things, changes in the borrower's employment status, changes in national, regional or local economic conditions, changes in interest rates or the availability of credit on favorable terms, changes in regional or local real estate values, changes in regional or local rental rates and changes in real estate taxes.

In the event of default under a loan held directly by us, we will bear a risk of loss of principal to the extent of any deficiency between the value of the collateral and the outstanding principal and accrued but unpaid interest of the loan, which could adversely affect our cash flow from operations. Foreclosure of a loan, particularly a commercial loan, can be an expensive and lengthy process, which would negatively affect our anticipated return on the foreclosed loan.

Mortgage and asset backed securities are bonds or notes backed by loans and/or other financial assets and include commercial mortgage back securities (CMBS), FNMA/FHLMC securities, and real estate related asset backed securities (ABS). The ability of a borrower to repay these loans or other financial assets is dependent upon the income or assets of these borrowers. If a borrower has insufficient income or assets to repay these loans, it will default on its loan. While we intend to focus on real estate related asset backed securities, there can be no assurance that we will not invest in other types of asset backed securities.

Our investments in mortgage and asset backed securities will be adversely affected by defaults under the loans underlying such securities. To the extent losses are realized on the loans underlying the securities in which we invest, we may not recover the amount invested in, or, in extreme cases, any of our investment in such securities.

**Our investments in debt securities are subject to specific risks relating to the particular issuer of the securities and to the general risks of investing in subordinated real estate securities.**

Our investments in debt securities involve special risks. REITs generally are required to invest substantially in real estate or real estate-related assets and are subject to the inherent risks associated with real estate-related investments discussed in this report. Our investments in debt are subject to the risks described above with respect to mortgage loans and MBS and similar risks, including:

- risks of delinquency and foreclosure, and risks of loss in the event thereof;
- the dependence upon the successful operation of and net income from real property;
- risks generally incident to interests in real property; and
- risks that may be presented by the type and use of a particular property.

Debt securities may be unsecured and may also be subordinated to other obligations of the issuer. We may also invest in debt securities that are rated below investment grade. As a result, investments in debt securities are also subject to risks of:

- limited liquidity in the secondary trading market;
- substantial market price volatility resulting from changes in prevailing interest rates or credit spreads;
- subordination to the prior claims of senior lenders to the issuer;
- the possibility that earnings of the debt security issuer may be insufficient to meet its debt service; and
- the declining creditworthiness and potential for insolvency of the issuer of such debt securities during periods of rising interest rates and economic downturn.

These risks may adversely affect the value of outstanding debt securities and the ability of the issuers thereof to repay principal and interest.

**We invest in excess MSR, and such investments could have a negative impact on our financial results.**

Subject to maintaining our qualification as a REIT and our exemption from the Investment Company Act of 1940, as amended (the “Investment Company Act”), we have purchased and may continue to purchase excess MSR with Nationstar, which is a leading residential mortgage servicer that is externally managed by our manager. We may also purchase excess MSR directly from Nationstar or enter into similar transaction with other bank or non-bank servicers.

Excess MSR are interests in mortgage servicing rights, representing a portion of the fee paid to mortgage servicers. The fee that a mortgage servicer is entitled to receive for servicing a pool of mortgages generally exceeds the reasonable compensation that would be charged in an arm’s-length transaction. For example, government-sponsored entities (“GSEs”), such as the Federal National Mortgage Association (“FNMA”) and the Federal Home Loan Mortgage Corp. (“FHLMC”), generally require mortgage servicers to be paid a minimum servicing fee that significantly exceeds the amount a servicer would charge in an arm’s-length transaction. The portion of the fee in excess of what would be charged in an arm’s-length transaction is commonly referred to as the excess mortgage servicing fee.

We record excess MSR on our balance sheet at fair value, and changes in their fair value are reflected in our consolidated results of operations. The determination of the fair value of excess MSR requires our management to make numerous estimates and assumptions that could materially differ from actual results. Such estimates and assumptions include, without limitation, estimates of the future cash flows from the excess mortgage servicing fees, which in turn are based upon assumptions about interest rates as well as prepayment rates, delinquencies and foreclosure rates of the underlying mortgage loans.

The ultimate realization of the value of excess MSR, which are measured at fair value on a recurring basis, may be materially different than the fair values of such excess MSR as may be reflected in our consolidated statement of financial position as of any particular date. The use of different estimates or assumptions in connection with the valuation of these assets could produce materially different fair values for such assets, which could have a material adverse effect on our consolidated financial position, results of operations and cash flows. Accordingly, there may be material uncertainty about the fair value of any excess MSR we acquire.

The values of excess MSR are highly sensitive to changes in interest rates. Historically, the value of excess MSR has increased when interest rates rise and decreased when interest rates decline due to the effect those changes in interest rates have on prepayment estimates. We may pursue various hedging strategies to seek to reduce our exposure to adverse changes in interest rates. Our hedging activity will vary in scope based on the level and volatility of interest rates, the type of assets held and other changing market conditions. Interest rate hedging may fail to protect or could adversely affect us. To the extent we do not utilize derivatives to hedge against changes in the fair value of excess MSR, our balance sheet,

results of operations and cash flows would be susceptible to significant volatility due to changes in the fair value of, or cash flows from, excess MSR as interest rates change.

Prepayment speeds significantly affect the value of excess MSRs. Prepayment speed is the measurement of how quickly borrowers pay down the unpaid principal balance of their loans or how quickly loans are otherwise brought current, modified, liquidated or charged off. When we purchase excess MSRs, we base the price we pay and the rate of amortization of those assets on, among other things, our projection of the cash flows from the related pool of mortgage loans. Our expectation of prepayment speeds is a significant assumption underlying those cash flow projections. If prepayment speeds are significantly greater than expected, the carrying value of excess MSRs could exceed their estimated fair value. If the fair value of excess MSRs decreases, we would be required to record a non-cash charge, which would have a negative impact on our financial results. Furthermore, a significant increase in prepayment speeds could materially reduce the ultimate cash flows we receive from excess MSRs, and we could ultimately receive substantially less than what we paid for such assets.

Moreover, delinquency rates have a significant impact on the value of excess MSRs. An increase in delinquencies will generally result in lower revenue because typically we will only collect servicing fees from GSEs or mortgage owners for performing loans. The price we pay for excess MSRs is based on, among other things, our projections of the cash flows from related pools of mortgage loans. Our expectation of delinquencies is a significant assumption underlying those cash flow projections. If delinquencies are significantly greater than expected, the estimated fair value of the excess MSRs could be diminished. As a result, we could suffer a loss, which would have a negative impact on our financial results.

Furthermore, MSRs are subject to numerous federal, state and local laws and regulations and may be subject to various judicial and administrative decisions imposing various requirements and restrictions on our business. If the servicer, actually or allegedly failed to comply with applicable laws, rules or regulations, it could be terminated as the servicer, which could have a material adverse effect on our business, financial condition, results of operations or cash flows.

Our ability to acquire excess MSRs will be subject to the applicable REIT qualification tests, and we may have to hold these interests through taxable REIT subsidiaries, which would negatively impact our returns from these assets.

**We will be dependent on mortgage servicers to service the mortgage loans underlying any mortgage servicing rights that we acquire.**

Our investments in MSRs or excess MSRs are dependent on the mortgage servicer to perform the servicing obligations. As a result, we could be materially and adversely affected if the servicer is terminated, or is unable to adequately service the underlying mortgage loans due to:

- its failure to comply with applicable laws and regulation;
- its failure to perform its loss mitigation obligations;
- a downgrade in its servicer rating;
- its failure to perform adequately in its external audits;
- a failure in its operational systems or infrastructure;
- regulatory scrutiny regarding foreclosure processes lengthening foreclosure timelines;
- a GSE's or a whole-loan owner's transfer of servicing to another party; or
- any other reason.

In addition, a bankruptcy by any mortgage servicer that services the mortgage loans underlying any mortgage servicing rights that we have acquired or may acquire in the future could result in:

- the validity and priority of our ownership in the mortgage servicing rights being challenged in a bankruptcy proceeding;
- payments made by such servicer to us, or obligations incurred by it, being avoided by a court under federal or state preference laws or federal or state fraudulent conveyance laws;
- a re-characterization of any sale of mortgage servicing rights or other assets to us as a pledge of such assets in a bankruptcy proceeding; or
- any agreement pursuant to which we purchased the mortgage servicing rights being rejected in a bankruptcy proceeding.

Any of the foregoing events could have a material and adverse effect on us.

**GSE initiatives and other actions may adversely affect returns from investments in MSRs or excess MSRs.**

On January 17, 2011, the Federal Housing Finance Agency announced that it has instructed FNMA and FHLMC to study possible alternatives to the current residential mortgage servicing and compensation system used for single-family mortgage loans. It is too early to determine what the GSEs, including FNMA and FHLMC, may propose as alternatives to current servicing compensation practices, or when any such alternatives would become effective. Although we do not expect MSRs that have already been created to be subject to any changes implemented by FNMA and FHLMC, it is possible that, because of the significant role of FNMA and FHLMC in the secondary mortgage market, any changes they implement could become prevalent in the mortgage servicing industry generally. Other industry stakeholders or regulators may also implement or require changes in response to the perception that the current mortgage servicing practices and compensation do not appropriately serve broader housing policy objectives. These proposals are still evolving. To the extent the GSEs implement reforms that materially affect the market for conforming loans, there may be secondary effects on the subprime and Alt-A markets. These reforms may have a material adverse effect on the economics or performance of any excess MSRs or MSRs that we may acquire in the future.

**Changes to the minimum servicing fee for GSE loans could occur at any time and could impact us in significantly negative ways that we are unable to predict or protect against.**

Currently, when a loan is sold into the secondary market for FNMA and FHLMC loans, the servicer is generally required to retain a minimum servicing fee (“MSF”) of 25 basis points of the outstanding principal balance for fixed rate mortgages. As has been widely publicized, in September 2011, the Federal Housing Finance Agency (FHFA) announced that a Joint Initiative on Mortgage Servicing Compensation was seeking public comment on two alternative mortgage servicing compensation structures detailed in a discussion paper. Changes to MSF could significantly impact our business in negative ways that we cannot predict or protect against. For example, a removal of MSF could radically change the mortgage servicing industry and could severely limit the excess MSRs that will be available for us to invest in. We cannot predict whether any changes to current MSF rules will occur or what impact any changes will have on our business, results of operations, liquidity or financial condition.

**We are subject to significant competition, and we may not compete successfully.**

We are subject to significant competition in seeking investments. We compete with other companies, including other REITs, mortgage servicers, insurance companies and other investors, including funds and companies affiliated with our manager. Some of our competitors have greater resources than we possess or have greater access to capital or various types of financing structures than are available to us, and we may not be able to compete successfully for investments or provide attractive investment returns relative to our competitors. These competitors may be willing to accept lower returns on their investments or to compromise underwriting standards and, as a result, our origination volume and profit margins could be adversely affected. Furthermore, competition for investments that are suitable for us may lead to the returns available from such investments decreasing, which may further limit our ability to generate our desired returns. We cannot assure you that other companies will not be formed that compete with us for investments or otherwise pursue investment strategies similar to ours or that we will be able to compete successfully against any such companies.

**Following the closing of a CDO financing when we have locked in the liability costs for a CDO during the reinvestment period, the rate at which we are able to acquire eligible investments and changes in market conditions may adversely affect our anticipated returns.**

During the reinvestment period, we must invest the restricted cash available for reinvestments in our CDOs. Until we are able to acquire sufficient assets, our returns will reflect income earned on uninvested cash and, having locked in the cost of liabilities for the particular CDO, the particular CDO’s returns will be at risk of declining to the extent that yields on the assets to be acquired decline. In general, our ability to acquire appropriate investments depends upon the supply in the market of investments we deem suitable, and changes in various economic factors may affect our determination of what constitutes a suitable investment.

**Our returns will be adversely affected when investments held in CDOs are prepaid or sold subsequent to the reinvestment period.**

Real estate securities and loans are subject to prepayment risk. In addition, we may sell, and realize gains (or losses) on, investments. To the extent such assets were held in CDOs subsequent to the end of the reinvestment period, the proceeds are fully utilized to pay down the related CDO’s debt. This causes the leverage on the CDO to decrease, thereby lowering our returns on equity.

**Our investments in senior unsecured REIT securities are subject to specific risks relating to the particular REIT issuer and to the general risks of investing in subordinated real estate securities, which may result in losses to us.**

Our investments in REIT securities involve special risks relating to the particular REIT issuer of the securities, including the financial condition and business outlook of the issuer. REITs generally are required to substantially invest in operating real estate or real estate related assets and are subject to the inherent risks associated with real estate related investments discussed in this report.

Our investments in REIT securities are also subject to the risks described above with respect to mortgage loans and mortgage backed securities and similar risks, including (i) risks of delinquency and foreclosure, and risks of loss in the event thereof, (ii) the dependence upon the successful operation of and net income from real property, (iii) risks generally incident to interests in real property, and (iv) risks that may be presented by the type and use of a particular commercial property.

REIT securities are generally unsecured and may also be subordinated to other obligations of the issuer. We may also invest in REIT securities that are rated below investment grade. As a result, investments in REIT securities are also subject to risks of: (i) limited liquidity in the secondary trading market, (ii) substantial market price volatility resulting from changes in prevailing interest rates, (iii) subordination to the prior claims of banks and other senior lenders to the issuer, (iv) the operation of mandatory sinking fund or call/redemption provisions during periods of declining interest rates that could cause the issuer to reinvest premature redemption proceeds in lower yielding assets, (v) the possibility that earnings of the REIT issuer may be insufficient to meet its debt service and dividend obligations and (vi) the declining creditworthiness and potential for insolvency of the issuer of such REIT securities during periods of rising interest rates and economic downturn. These risks may adversely affect the value of outstanding REIT securities and the ability of the issuers thereof to repay principal and interest or make dividend payments.

**The real estate related loans and other direct and indirect interests in pools of real estate properties or other loans that we invest in may be subject to additional risks relating to the structure and terms of these transactions, which may result in losses to us.**

We invest in real estate related loans and other direct and indirect interests in pools of real estate properties or loans such as mezzanine loans and “B Note” mortgage loans. We invest in mezzanine loans that take the form of subordinated loans secured by second mortgages on the underlying real property or other business assets or revenue streams or loans secured by a pledge of the ownership interests of the entity owning real property or other business assets or revenue streams (or the ownership interest of the parent of such entity). These types of investments involve a higher degree of risk than long-term senior lending secured by business assets or income producing real property because the investment may become unsecured as a result of foreclosure by a senior lender. In the event of a bankruptcy of the entity providing the pledge of its ownership interests as security, we may not have full recourse to the assets of such entity, or the assets of the entity may not be sufficient to repay our mezzanine loan. If a borrower defaults on our mezzanine loan or debt senior to our loan, or in the event of a borrower bankruptcy, our mezzanine loan will be satisfied only after the senior debt is repaid in full. As a result, we may not recover some or all of our investment. In addition, mezzanine loans may have higher loan to value ratios than conventional mortgage loans, resulting in less equity in the property and increasing the risk of loss of principal.

We also invest in mortgage loans (“B Notes”) that while secured by a first mortgage on a single large commercial property or group of related properties are subordinated to an “A Note” secured by the same first mortgage on the same collateral. As a result, if an issuer defaults, there may not be sufficient funds remaining for B Note holders. B Notes reflect similar credit risks to comparably rated commercial mortgage backed securities. In addition, we invest, directly or indirectly, in pools of real estate properties or loans. Since each transaction is privately negotiated, these investments can vary in their structural characteristics and risks. For example, the rights of holders of B Notes to control the process following a borrower default may vary from transaction to transaction, while investments in pools of real estate properties or loans may be subject to varying contractual arrangements with third party co-investors in such pools. Further, B Notes typically are secured by a single property, and so reflect the risks associated with significant concentration. These investments also are less liquid than commercial mortgage backed securities.

**Investment in non-investment grade loans may involve increased risk of loss.**

We have acquired and may continue to acquire in the future certain loans that do not conform to conventional loan criteria applied by traditional lenders and are not rated or are rated as non-investment grade (for example, for investments rated by Moody’s Investors Service, ratings lower than Baa3, and for Standard & Poor’s, BBB- or below). The non-investment grade ratings for these loans typically result from the overall leverage of the loans, the lack of a strong operating history for the properties underlying the loans, the borrowers’ credit history, the properties’ underlying cash flow or other factors. As a result, these loans have a higher risk of default and loss than conventional loans. Any loss we incur may reduce

distributions to our stockholders. There are no limits on the percentage of unrated or non-investment grade assets we may hold in our portfolio.

**Insurance on real estate in which we have interests (including the real estate serving as collateral for our real estate securities and loans) may not cover all losses.**

There are certain types of losses, generally of a catastrophic nature, such as earthquakes, floods, hurricanes, terrorism or acts of war, that may be uninsurable or not economically insurable. Inflation, changes in building codes and ordinances, environmental considerations, and other factors, including terrorism or acts of war, also might make the insurance proceeds insufficient to repair or replace a property if it is damaged or destroyed. Under such circumstances, the insurance proceeds received might not be adequate to restore our economic position with respect to the affected real property. As a result of the events of September 11, 2001, insurance companies have limited or excluded coverage for acts of terrorism in insurance policies. As a result, we may suffer losses from acts of terrorism that are not covered by insurance.

In addition, the mortgage loans that are secured by certain of the properties in which we have interests contain customary covenants, including covenants that require property insurance to be maintained in an amount equal to the replacement cost of the properties. There can be no assurance that the lenders under these mortgage loans will not take the position that exclusions from coverage for losses due to terrorist acts is a breach of a covenant which, if uncured, could allow the lenders to declare an event of default and accelerate repayment of the mortgage loans.

**Many of our investments are illiquid, and this lack of liquidity could significantly impede our ability to vary our portfolio in response to changes in economic and other conditions or to realize the value at which such investments are carried if we are required to dispose of them.**

The real estate properties that we own and operate and our other direct and indirect investments in real estate and real estate related assets are generally illiquid. In addition, the real estate securities that we purchase in connection with privately negotiated transactions are not registered under the relevant securities laws, resulting in a prohibition against their transfer, sale, pledge or other disposition except in a transaction that is exempt from the registration requirements of, or is otherwise in accordance with, those laws. In addition, there are no established trading markets for a majority of our investments. As a result, our ability to vary our portfolio in response to changes in economic and other conditions may be limited.

Our securities have historically been valued based primarily on third party quotations, which are subject to significant variability based on the liquidity and price transparency created by market trading activity. The ongoing dislocation in the trading markets has continued to reduce the trading for many real estate securities, resulting in less transparent prices for those securities. Consequently, it is currently more difficult for us to sell many of our assets than it has been historically because, if we were to sell such assets, we would likely not have access to readily ascertainable market prices when establishing valuations of them. Moreover, currently there is a relatively low market demand for the vast majority of the types of assets that we hold, which may make it extremely difficult to sell our assets. If we are required to liquidate all or a portion of our illiquid investments quickly, we may realize significantly less than the amount at which we have previously valued these investments.

**Interest rate fluctuations and shifts in the yield curve may cause losses.**

Our primary interest rate exposures relate to our real estate securities, loans, floating rate debt obligations and interest rate swaps. Changes in interest rates, including changes in expected interest rates or “yield curves,” affect our business in a number of ways. Changes in the general level of interest rates can affect our net interest income, which is the difference between the interest income earned on our interest-earning assets and the interest expense incurred in connection with our interest-bearing liabilities and hedges. Changes in the level of interest rates also can affect, among other things, our ability to acquire real estate securities and loans at attractive prices, the value of our real estate securities, loans and derivatives and our ability to realize gains from the sale of such assets. In the past, we have utilized hedging transactions to protect our positions from interest rate fluctuations, but as a result of current market conditions we face significant obstacles to entering into new hedging transactions. As a result, we may not be able to protect new investments from interest rate fluctuations to the same degree as in the past, which could adversely affect our financial condition and results of operations.

In the event of a significant rising interest rate environment and/or economic downturn, loan and collateral defaults may increase and result in credit losses that would adversely affect our liquidity and operating results. Interest rates are highly sensitive to many factors, including governmental monetary and tax policies, domestic and international economic and political conditions, and other factors beyond our control.

Our ability to execute our business strategy, particularly the growth of our investment portfolio, depends to a significant degree on our ability to obtain additional capital. Our financing strategy is dependent on our ability to place the match funded debt we use to finance our investments at rates that provide a positive net spread. If spreads for such liabilities

widen or if demand for such liabilities ceases to exist, then our ability to execute future financings will be severely restricted.

Interest rate changes may also impact our net book value as our real estate securities, real estate related loans and hedge derivatives are marked to market each quarter. Debt obligations are not marked to market. Generally, as interest rates increase, the value of our fixed rate securities decreases, which will decrease the book value of our equity.

Furthermore, shifts in the U.S. Treasury yield curve reflecting an increase in interest rates would also affect the yield required on our real estate securities and therefore their value. For example, increasing interest rates would reduce the value of the fixed rate assets we hold at the time because the higher yields required by increased interest rates result in lower market prices on existing fixed rate assets in order to adjust the yield upward to meet the market, and vice versa. This would have similar effects on our real estate securities portfolio and our financial position and operations to a change in interest rates generally.

**We may invest in senior living facilities, which are subject to various risks that could have a negative impact on our financial results.**

Subject to maintaining our qualification as a REIT, we may invest in senior living facilities. In connection with any such investment, we expect that we would engage a third party (possibly an affiliate of our manager) to manage the operations of these facilities, for which we would pay a management fee. The income from any senior living facilities would be dependent on the ability of the managers of such facilities to successfully manage these properties. The managers would compete with other companies on a number of different levels, including: the quality of care provided, reputation, the physical appearance of a facility, price and range of services offered, alternatives for healthcare delivery, the supply of competing properties, physicians, staff, referral sources, location, the size and demographics of the population in surrounding areas, and the financial condition of tenants and managers. A manager's inability to successfully compete with other companies on one or more of the foregoing levels could adversely affect the senior living facility and materially reduce the income we would receive from an investment in such facility.

In addition, private, federal and state payment programs as well as the effect of laws and regulations may also have a significant impact on the profitability of such facilities. The failure of a manager to comply with any of these laws could result in the loss of accreditation, denial of reimbursement, imposition of fines, suspension or decertification from federal and state healthcare programs, loss of license or closure of the facility. These events, among others, could result in the loss of part or all of any investment we make in a senior living facility.

Furthermore, the ability to successfully manage a senior living facility depends on occupancy levels. Any senior living facility in which we invest may have relatively flat or declining occupancy levels due to falling home prices, declining incomes, stagnant home sales and other economic factors. In addition, the senior housing segment may continue to experience a decline in occupancy due to the weak economy and the associated decision of certain residents to vacate a facility and instead be cared for at home. A material decline in occupancy levels and revenues may make it more difficult for the manager of any senior living facility in which we invest to successfully generate income for us. Alternatively, to avoid a decline in occupancy, a manager may reduce the rates charged, which would also reduce our revenues and therefore negatively impact the ability to generate income.

**Our investments in real estate securities and loans are subject to changes in credit spreads, which could adversely affect our ability to realize gains on the sale of such investments.**

Real estate securities and loans are subject to changes in credit spreads. Credit spreads measure the yield demanded on securities and loans by the market based on their credit relative to a specific benchmark.

Fixed rate securities and loans are valued based on a market credit spread over the rate payable on fixed rate U.S. Treasuries of like maturity. Floating rate securities and loans are valued based on a market credit spread over LIBOR and are affected similarly by changes in LIBOR spreads. Excessive supply of these securities combined with reduced demand will generally cause the market to require a higher yield on these securities and loans, resulting in the use of a higher, or "wider," spread over the benchmark rate to value such securities. Under such conditions, the value of our real estate securities and loan portfolios would tend to decline. Conversely, if the spread used to value such securities were to decrease, or "tighten," the value of our real estate securities portfolio would tend to increase. Such changes in the market value of our real estate securities and loan portfolios may affect our net equity, net income or cash flow directly through their impact on unrealized gains or losses on available-for-sale securities, and therefore our ability to realize gains on such securities, or indirectly through their impact on our ability to borrow and access capital. During 2008 through the first quarter of 2009, credit spreads widened substantially. This widening of credit spreads caused the net unrealized gains on our securities, loans and derivatives, recorded in accumulated other comprehensive income or retained earnings, and therefore our book value per share, to decrease and resulted in net losses.

In addition, if the value of our loans subject to financing agreements were to decline, it could affect our ability to refinance such loans upon the maturity of the related repurchase agreements. Any credit or spread related losses incurred with respect to our loans would affect us in the same way as similar losses on our real estate securities portfolio as described above.

**Any hedging transactions that we enter into may limit our gains or result in losses.**

We have used (and may continue to use, when feasible and appropriate) derivatives to hedge a portion of our interest rate exposure, and this approach has certain risks, including the risk that losses on a hedge position will reduce the cash available for distribution to stockholders and that such losses may exceed the amount invested in such instruments. We have adopted a general policy with respect to the use of derivatives, which generally allows us to use derivatives where appropriate, but does not set forth specific policies and procedures or require that we hedge any specific amount of risk. From time to time, we use derivative instruments, including forwards, futures, swaps and options, in our risk management strategy to limit the effects of changes in interest rates on our operations. A hedge may not be effective in eliminating all of the risks inherent in any particular position. Our profitability may be adversely affected during any period as a result of the use of derivatives.

There are limits to the ability of any hedging strategy to protect us completely against interest rate risks. When rates change, we expect the gain or loss on derivatives to be offset by a related but inverse change in the value of the items, generally our liabilities, that we hedge. We cannot assure you, however, that our use of derivatives will offset the risks related to changes in interest rates. We cannot assure you that our hedging strategy and the derivatives that we use will adequately offset the risk of interest rate volatility or that our hedging transactions will not result in losses. In addition, our hedging strategy may limit our flexibility by causing us to refrain from taking certain actions that would be potentially profitable but would cause adverse consequences under the terms of our hedging arrangements.

The REIT provisions of the Internal Revenue Code of 1986, as amended, or the Code, limit our ability to hedge. In managing our hedge instruments, we consider the effect of the expected hedging income on the REIT qualification tests that limit the amount of gross income that a REIT may receive from hedging. We need to carefully monitor, and may have to limit, our hedging strategy to assure that we do not realize hedging income, or hold hedges having a value, in excess of the amounts that would cause us to fail the REIT gross income and asset tests.

Accounting for derivatives under U.S. generally accepted accounting principles, or GAAP, is extremely complicated. Any failure by us to account for our derivatives properly in accordance with GAAP in our financial statements could adversely affect our earnings.

**Under certain conditions, increases in prepayment rates can adversely affect yields on many of our investments.**

The value of the majority of assets in which we invest may be affected by prepayment rates on these assets. Prepayment rates are influenced by changes in current interest rates and a variety of economic, geographic and other factors beyond our control, and consequently, such prepayment rates cannot be predicted with certainty. In periods of declining mortgage interest rates, prepayments on loans generally increase. If general interest rates decline as well, the proceeds of such prepayments received during such periods are likely to be reinvested by us in assets yielding less than the yields on the assets that were prepaid. In addition, the market value of floating rate assets may, because of the risk of prepayment, benefit less than fixed rate assets from declining interest rates. Conversely, in periods of rising interest rates, prepayments on loans generally decrease, in which case we would not have the prepayment proceeds available to invest in assets with higher yields. Under certain interest rate and prepayment scenarios we may fail to recoup fully our cost of acquisition of certain investments.

In addition, when market conditions lead us to increase the portion of our CDO investments that are comprised of floating rate securities, the risk of assets inside our CDOs prepaying increases. Since our CDO financing costs are locked in, reinvestment of such prepayment proceeds at lower yields than the initial investments, as a result of changes in the interest rate or credit spread environment, will result in a decrease of the return on our equity and therefore our net income.

**Changes in accounting rules could occur at any time and could impact us in significantly negative ways that we are unable to predict or protect against.**

As has been widely publicized, the SEC, the Financial Accounting Standards Board and other regulatory bodies that establish the accounting rules applicable to us have recently proposed or enacted a wide array of changes to accounting rules. Moreover, in the future these regulators may propose additional changes that we do not currently anticipate. Changes to accounting rules that apply to us could significantly impact our business or our reported financial performance in negative ways that we cannot predict or protect against. We cannot predict whether any changes to current accounting rules will occur or what impact any codified changes will have on our business, results of operations, liquidity or financial condition.

**Environmental compliance costs and liabilities with respect to real estate in which we have interests may adversely affect our results of operations.**

Our operating costs may be affected by our obligation to pay for the cost of complying with existing environmental laws, ordinances and regulations, as well as the cost of complying with future legislation with respect to the assets, or loans secured by assets, with environmental problems that materially impair the value of the assets. Under various federal, state and local environmental laws, ordinances and regulations, a current or previous owner or operator of real property may be liable for the costs of removal or remediation of hazardous or toxic substances on, under, or in such property. Such laws often impose liability whether or not the owner or operator knew of, or was responsible for, the presence of such hazardous or toxic substances. In addition, the presence of hazardous or toxic substances, or the failure to remediate properly, may adversely affect the owner's ability to borrow using such real property as collateral. Certain environmental laws and common law principles could be used to impose liability for releases of hazardous materials, including asbestos-containing materials, into the environment, and third parties may seek recovery from owners or operators of real properties for personal injury associated with exposure to released asbestos-containing materials or other hazardous materials. Environmental laws may also impose restrictions on the manner in which a property may be used or transferred or in which businesses it may be operated, and these restrictions may require expenditures. In connection with the direct or indirect ownership and operation of properties, we may be potentially liable for any such costs. The cost of defending against claims of liability or remediating contaminated property and the cost of complying with environmental laws could adversely affect our results of operations and financial condition.

**Lawsuits, investigations and indemnification claims could result in significant liabilities and reputational harm, which could materially adversely affect our results of operations, financial condition and liquidity.**

From time to time, we may be involved in lawsuits or investigations or receive claims for indemnification. Our efforts to resolve any such lawsuits, investigations or claims could be very expensive and highly damaging to our reputation, even if the underlying claims are without merit. We could potentially be found liable for significant damages or indemnification obligations. Such developments could have a material adverse effect on our business, results of operations and financial condition.

*Risks Relating to Our REIT Status and Other Matters*

**Our failure to qualify as a REIT would result in higher taxes and reduced cash available for distribution to our stockholders.**

We operate in a manner intended to qualify us as a REIT for federal income tax purposes. Our ability to satisfy the asset tests depends upon our analysis of the fair market values of our assets, some of which are not susceptible to a precise determination, and for which we do not obtain independent appraisals. Our compliance with the REIT income and quarterly asset requirements also depends upon our ability to successfully manage the composition of our income and assets on an ongoing basis. Moreover, the proper classification of an instrument as debt or equity for federal income tax purposes, and the tax treatment of participation interests that we hold in mortgage loans and mezzanine loans, may be uncertain in some circumstances, which could affect the application of the REIT qualification requirements. Accordingly, there can be no assurance that the Internal Revenue Service, or IRS, will not contend that our interests in subsidiaries or other issuers violate the REIT requirements.

If we were to fail to qualify as a REIT in any taxable year, we would be subject to federal income tax, including any applicable alternative minimum tax, on our taxable income at regular corporate rates, and distributions to stockholders would not be deductible by us in computing our taxable income. Any such corporate tax liability could be substantial and would reduce the amount of cash available for distribution to our stockholders, which in turn could have an adverse impact on the value of, and trading prices for, our stock. Unless entitled to relief under certain provisions of the Code, we also would be disqualified from taxation as a REIT for the four taxable years following the year during which we initially ceased to qualify as a REIT.

**Our failure to qualify as a REIT would create issues under a number of our financings and other agreements and would cause our common and preferred stock to be delisted from the NYSE.**

Our failure to qualify as a REIT would create issues under a number of our financing and other agreements. In addition, the New York Stock Exchange (the "NYSE") requires, as a condition to the continued listing of our common and preferred shares, that we maintain our REIT status. Consequently, if we fail to maintain our REIT status, our common and preferred shares would promptly be delisted from the NYSE, which would decrease the trading activity of such shares. This could make it difficult to sell shares and could cause the market volume of the shares trading to decline.

If we were delisted as a result of losing our REIT status and desired to relist our shares on the NYSE, we would have to reapply to the NYSE to be listed as a domestic corporation. As the NYSE's listing standards for REITs are less onerous than its standards for domestic corporations, it would be more difficult for us to become a listed company under these heightened standards. Given current conditions, we might not be able to satisfy the NYSE's listing standards for a domestic corporation. As a result, if we were delisted from the NYSE, we might not be able to relist as a domestic corporation, in which case our common and preferred shares could not trade on the NYSE.

**The failure of assets subject to repurchase agreements to qualify as real estate assets could adversely affect our ability to qualify as a REIT.**

We may enter into financing arrangements that are structured as sale and repurchase agreements pursuant to which we would nominally sell certain of our assets to a counterparty and simultaneously enter into an agreement to repurchase these assets at a later date in exchange for a purchase price. Economically, these agreements are financings that are secured by the assets sold pursuant thereto. We believe that, for purposes of the REIT asset and income tests, we should be treated as the owner of the assets that are the subject of any such sale and repurchase agreement, notwithstanding that those agreements may transfer record ownership of the assets to the counterparty during the term of the agreement. It is possible, however, that the IRS could assert that we did not own the assets during the term of the sale and repurchase agreement, in which case we might fail to qualify as a REIT.

**Dividends payable by REITs do not qualify for the reduced tax rates.**

Tax law changes in 2010 extended the 2003 reduction of the maximum tax rate for dividends payable to individuals from 35% to 15% through 2012. Dividends payable by REITs, however, are generally not eligible for the reduced rates. Although this legislation does not adversely affect the taxation of REITs or dividends paid by REITs, the more favorable rates applicable to regular corporate dividends could cause investors who are individuals, trusts and estates to perceive investments in REITs to be relatively less attractive than investments in the stocks of non-REIT corporations that pay dividends, which could adversely affect the value of the stock of REITs, including our common stock. In addition, the relative attractiveness of real estate in general may be adversely affected by the newly favorable tax treatment given to corporate dividends, which could affect the value of our real estate assets negatively.

**REIT distribution requirements could adversely affect our liquidity and our ability to execute our business plan.**

We generally must distribute annually at least 90% of our net taxable income, excluding any net capital gain, in order for corporate income tax not to apply to earnings that we distribute. We intend to make distributions to our stockholders to comply with the requirements of the Code. However, differences in timing between the recognition of taxable income and the actual receipt of cash could require us to sell assets or borrow funds on a short-term or long-term basis to meet the 90% distribution requirement of the Code. Certain of our assets may generate substantial mismatches between taxable income and available cash. As a result, the requirement to distribute a substantial portion of our net taxable income could cause us to: (i) sell assets in adverse market conditions, (ii) borrow on unfavorable terms or (iii) distribute amounts that would otherwise be invested in future acquisitions, capital expenditures or repayment of debt, in order to comply with REIT requirements. Further, amounts distributed will not be available to fund investment activities. If we fail to obtain debt or equity capital in the future, it could limit our ability to satisfy our liquidity needs, which could adversely affect the value of our common stock.

As of December 31, 2010, we had a loss carryforward, inclusive of net operating loss and capital loss, of approximately \$1.05 billion. The net operating loss carryforward and capital loss carryforward can generally be used to offset future ordinary taxable income and capital gain, for up to twenty years and five years, respectively. As a result, we do not expect that there will be any REIT distribution requirements for the year ending December 31, 2011, except as described below.

**Our ability to utilize net operating loss carryforwards and certain built-in losses to reduce our future taxable income and related REIT distribution requirements may become limited by provisions of the Code, thereby jeopardizing our ability to maintain our status as a REIT.**

In order to maintain our tax status as a REIT, we are generally required to distribute at least 90% of our REIT taxable income (determined without regard to the dividends paid deduction and not including net capital gains) each year to our stockholders. To qualify for the tax benefits accorded to REITs, we intend to make distributions to our stockholders such that we distribute all or substantially all our net taxable income (if any) each year, subject to certain adjustments. However, our ability to meet this distribution requirement and maintain our status as a REIT may be adversely affected if certain provisions of the Code prevent us from utilizing our net operating loss carryforwards and certain built-in losses to reduce our taxable income, thereby increasing both our taxable income and the related REIT distribution requirement to a level that we are unable to satisfy. Specifically, the Code limits the ability of a company that undergoes an "ownership change" to utilize its net operating loss carryforwards and certain built-in losses to offset taxable income earned in years after the

ownership change. An ownership change occurs if, during a three-year testing period, more than 50% of the stock of a company is acquired by one or more persons (or certain groups of persons) who own, directly or constructively, 5% or more of the stock of such company. An ownership change can occur as a result of a public offering of stock, as well as through secondary market purchases of our stock and certain types of reorganization transactions.

Generally, if an ownership change occurs, the annual limitation on the use of net operating loss carryforwards and certain built-in losses is equal to the product of the applicable long-term tax exempt rate and the value of the company's stock immediately before the ownership change. If we were to undergo an ownership change as a result of a stock offering or otherwise, depending on the aggregate value of our stock and the level of the applicable federal tax rate at the time of the ownership change, we might be unable to use our net operating loss carryforwards and built-in losses to offset our taxable income, and we would therefore be required to distribute larger amounts to our stockholders in order to maintain our status as a REIT. No assurance can be given that we will be able to satisfy our distribution requirement following an ownership change or otherwise. If we were to fail to satisfy our distribution requirement, it would cause us to lose our REIT status and thereby materially negatively impact our business, financial condition and potentially impair our ability to continue operating in the future.

**We may be required to report taxable income for certain investments in excess of the economic income we ultimately realize from them.**

We may acquire debt instruments in the secondary market for less than their face amount. The amount of such discount will generally be treated as "market discount" for federal income tax purposes. Accrued market discount is generally recognized as taxable income over our holding period in the instrument in advance of the receipt of cash. If we collect less on the debt instrument than our purchase price plus the market discount we had previously reported as income, we may not be able to benefit from any offsetting loss deductions.

In addition, we may acquire debt investments that are subsequently modified by agreement with the borrower. If the amendments to the outstanding debt are "significant modifications" under the applicable Treasury regulations, the modified debt may be considered to have been reissued to us in a debt-for-debt exchange with the borrower. In that event, we may be required to recognize taxable gain to the extent the principal amount of the modified debt exceeds our adjusted tax basis in the unmodified debt, even if the value of the debt or the payment expectations have not changed. Following such a taxable modification, we would hold the modified loan with a cost basis equal to its principal amount for federal tax purposes.

Moreover, in the event that any debt instruments acquired by us are delinquent as to mandatory principal and interest payments, or in the event payments with respect to a particular debt instrument are not made when due, we may nonetheless be required to continue to recognize the unpaid interest as taxable income. Similarly, we may be required to accrue interest income with respect to subordinate mortgage-backed securities at the stated rate regardless of whether corresponding cash payments are received.

**The IRS tax rules regarding recognizing capital losses and ordinary income for our non-recourse financings, coupled with current REIT distribution requirements, could result in our recognizing significant taxable net income without receiving an equivalent amount of cash proceeds from which to make required distributions. This disconnect could have a serious, negative effect on us.**

We may experience issues regarding the characterization of income for tax purposes. For example, we may recognize significant ordinary income, which we would not be able to offset with capital losses, which would, in turn, increase the amount of income we would be required to distribute to shareholders in order to maintain our REIT status. We expect that this disconnect will occur in the case of one or more of our non-recourse financing structures, including off balance sheet structures such as our subprime securitizations and non-consolidated CDOs, where we incur capital losses on the related assets, and ordinary income from the cancellation of the related non-recourse financing if the ultimate proceeds from the assets are insufficient to repay such debt. Through December 31, 2011, no such cancellation of CDO debt had been effected as a result of losses incurred. However, we expect that such cancellation of indebtedness within our CDOs, consolidated or non-consolidated, may occur in the future. In the case of our subprime securitizations, \$32.3 million of such cancellations had been effected through December 31, 2011, and we expect such cancellations will continue as losses are realized. This disconnect could also occur, and has occurred, as a result of the repurchase of our outstanding debt at a discount as the gain recorded upon the cancellation of indebtedness is characterized as ordinary income for tax purposes. We have repurchased our debt at a discount in the past, and we intend to attempt to do so in the future. During 2009 and 2010, we repurchased \$787.8 million face amount of our outstanding CDO debt and junior subordinated notes at a discount, and recorded \$521.1 million of gain. In compliance with tax laws, we had the ability to defer the ordinary income recorded as a result of this cancellation of indebtedness to future years and have deferred or intend to defer all or a portion of such gain for 2009 and 2010. While such deferral may postpone the effect of the disconnect on the ability to offset taxable income and losses, it does not eliminate it. Furthermore, cancellation of indebtedness income recognized on or after January 1, 2011 cannot be deferred and must generally be recognized as ordinary income in the year of such cancellation. During the year ended

December 31, 2011, we repurchased \$193.2 million face amount of our outstanding CDO debt and notes payable at a discount and recorded \$82.2 million of gain for tax purposes (of which only \$66.1 million gain relating to \$171.8 million face amount of debt repurchased was recognized for GAAP purposes). The elimination of the ability to defer the recognition of cancellation of indebtedness income introduces additional tax implications that may significantly reduce the economic benefit of repurchasing our outstanding CDO debt.

When we experience any of these disconnects, and to the extent that a distribution through stock dividends is not viable, we may not have sufficient cashflow to make the distributions necessary to satisfy our REIT distribution requirements, which would cause us to lose our REIT status and thereby materially negatively impact our business, financial condition and potentially impair our ability to continue operating in the future. Under current market conditions, this type of disconnect between taxable income and cash proceeds would be likely to occur at some point in the future if the current regulations that create the disconnect are not revised, but we cannot predict at this time when such a disconnect might occur.

**We may be unable to generate sufficient revenue from operations to pay our operating expenses and to pay distributions to our stockholders.**

As a REIT, we are generally required to distribute at least 90% of our REIT taxable income (determined without regard to the dividends paid deduction and not including net capital losses) each year to our stockholders. To qualify for the tax benefits accorded to REITs, we intend to make distributions to our stockholders in amounts such that we distribute all or substantially all of our net taxable income each year, subject to certain adjustments. However, our ability to make distributions may be adversely affected by the risk factors described herein, particularly in light of current market conditions. In the event of a sustained downturn in our operating results and financial performance relative to previous periods or sustained declines in the value of our asset portfolio, we may be unable to declare or pay quarterly distributions or make distributions to our stockholders, and we may elect to comply with our REIT distribution requirements by, after completing various procedural steps, distributing, under certain circumstances, a portion of the required amount in the form of common shares in lieu of cash. The timing and amount of distributions are in the sole discretion of our board of directors, which considers, among other factors, our earnings, financial condition, debt service obligations and applicable debt covenants, REIT qualification requirements and other tax considerations and capital expenditure requirements as our board may deem relevant from time to time.

**The stock ownership limit imposed by the Internal Revenue Code for REITs and our charter may inhibit market activity in our stock and restrict our business combination opportunities.**

In order for us to maintain our qualification as a REIT under the Code, not more than 50% in value of our outstanding stock may be owned, directly or indirectly, by five or fewer individuals (as defined in the Code to include certain entities) at any time during the last half of each taxable year after our first year. Our charter, with certain exceptions, authorizes our board of directors to take the actions that are necessary and desirable to preserve our qualification as a REIT. Unless exempted by our board of directors, no person may own more than 8% of the aggregate value of our outstanding capital stock, treating classes and series of our stock in the aggregate, or more than 25% of the outstanding shares of our Series B Preferred Stock, Series C Preferred Stock or Series D Preferred Stock. Our board may grant an exemption in its sole discretion, subject to such conditions, representations and undertakings as it may determine in its sole discretion. These ownership limits could delay or prevent a transaction or a change in our control that might involve a premium price for our common stock or otherwise be in the best interest of our stockholders. Our board has granted limited exemptions to an affiliate of our manager, a third party group of funds managed by Cohen & Steers, and certain affiliates of these entities.

**Even if we remain qualified as a REIT, we may face other tax liabilities that reduce our cash flow.**

Even if we remain qualified for taxation as a REIT, we may be subject to certain federal, state and local taxes on our income and assets, including taxes on any undistributed income, tax on income from some activities conducted as a result of a foreclosure, and state or local income, property and transfer taxes, such as mortgage recording taxes. Moreover, if a REIT distributes less than 85% of its taxable income to its stockholders during any calendar year (including any distributions declared by the last day of the calendar year but paid in the subsequent year), then it is required to pay an excise tax on 4% of any shortfall between the required 85% and the amount that was actually distributed. Any of these taxes would decrease cash available for distribution to our stockholders. In addition, in order to meet the REIT qualification requirements, or to avert the imposition of a 100% tax that applies to certain gains derived by a REIT from dealer property or inventory, we may hold some of our assets through taxable REIT subsidiaries. Such subsidiaries will be subject to corporate level income tax at regular rates.

**Complying with REIT requirements may cause us to forego otherwise attractive opportunities.**

To qualify as a REIT for federal income tax purposes, we must continually satisfy tests concerning, among other things, the sources of our income, the nature and diversification of our assets, the amounts we distribute to our stockholders and the

ownership of our stock. We also may be required to make distributions to stockholders at disadvantageous times or when we do not have funds readily available for distribution. Thus, compliance with the REIT requirements may hinder our ability to make certain attractive investments.

**Complying with REIT requirements may limit our ability to hedge effectively.**

The existing REIT provisions of the Code may substantially limit our ability to hedge our operations because a significant amount of the income from those hedging transactions is likely to be treated as non-qualifying income for purposes of both REIT gross income tests. In addition, we must limit our aggregate income from non-qualified hedging transactions, from our provision of services and from other non-qualifying sources, to less than 5% of our annual gross income (determined without regard to gross income from qualified hedging transactions). As a result, we may have to limit our use of certain hedging techniques or implement those hedges through total return swaps. This could result in greater risks associated with changes in interest rates than we would otherwise want to incur or could increase the cost of our hedging activities. If we fail to comply with these limitations, we could lose our REIT qualification for federal income tax purposes, unless our failure was due to reasonable cause, and not due to willful neglect, and we meet certain other technical requirements. Even if our failure were due to reasonable cause, we might incur a penalty tax.

**The “taxable mortgage pool” rules may increase the taxes that we or our stockholders may incur, and may limit the manner in which we effect future securitizations.**

Certain of our securitizations have resulted in the creation of taxable mortgage pools for federal income tax purposes. As a REIT, so long as we own 100% of the equity interests in a taxable mortgage pool, we would generally not be adversely affected by the characterization of the securitization as a taxable mortgage pool. Certain categories of stockholders, however, such as foreign stockholders eligible for treaty or other benefits, stockholders with net operating losses, and certain tax-exempt stockholders that are subject to unrelated business income tax, could be subject to increased taxes on a portion of their dividend income from us that is attributable to the taxable mortgage pool. In addition, to the extent that our stock is owned by tax-exempt “disqualified organizations,” such as certain government-related entities and charitable remainder trusts that are not subject to tax on unrelated business income, we could incur a corporate level tax on a portion of our income from the taxable mortgage pool. In that case, we might reduce the amount of our distributions to any disqualified organization whose stock ownership gave rise to the tax.

**Maintenance of our Investment Company Act exemption imposes limits on our operations.**

We conduct our operations so as not to become regulated as an investment company under the Investment Company Act. We believe that there are a number of exemptions under the Investment Company Act that may be applicable to us. The assets that we may acquire, therefore, are limited by the provisions of the Investment Company Act and the rules and regulations promulgated under the Investment Company Act. In addition, we could, among other things, be required either (a) to change the manner in which we conduct our operations to avoid being required to register as an investment company or (b) to register as an investment company, either of which could adversely affect us and the market price for our stock.

The SEC recently solicited public comment on a wide range of issues relating to Section 3(c)(5)(C) of the Investment Company Act, including the nature of the assets that qualify for purposes of the exemption and whether mortgage REITs should be regulated in a manner similar to investment companies. There can be no assurance that the laws and regulations governing the Investment Company Act status of REITs, or SEC guidance regarding these exemptions, will not change in a manner that adversely affects our operations. If the SEC takes action that could result in our or our subsidiaries’ failure to maintain an exception or exemption from the Investment Company Act, we could, among other things, be required either to (a) change the manner in which we conduct our operations to avoid being required to register as an investment company, (b) effect sales of our assets in a manner that, or at a time when, we would not otherwise choose to do so, or (c) register as an investment company (which, among other things, would require us to comply with the leverage constraints applicable to investment companies), any of which could negatively affect the value of our common stock, the sustainability of our business model, and our ability to make distributions to our shareholders, which could, in turn, materially and adversely affect us and the market price of our shares.

**ERISA may restrict investments by plans in our common stock.**

A plan fiduciary considering an investment in our common stock should consider, among other things, whether such an investment is consistent with the fiduciary obligations under the Employee Retirement Income Security Act of 1974, as amended, or ERISA, including whether such investment might constitute or give rise to a prohibited transaction under ERISA, the Code or any substantially similar federal, state or local law and, if so, whether an exemption from such prohibited transaction rules is available.

### **Maryland takeover statutes may prevent a change of our control, which could depress our stock price.**

Under Maryland law, “business combinations” between a Maryland corporation and an interested stockholder or an affiliate of an interested stockholder are prohibited for five years after the most recent date on which the interested stockholder becomes an interested stockholder. These business combinations include certain mergers, consolidations, share exchanges, or, in circumstances specified in the statute, an asset transfer or issuance or reclassification of equity securities or a liquidation or dissolution. An interested stockholder is defined as:

- any person who beneficially owns 10% or more of the voting power of the corporation's outstanding shares; or
- an affiliate or associate of a corporation who, at any time within the two-year period prior to the date in question, was the beneficial owner of 10% or more of the voting power of the then outstanding stock of the corporation.

A person is not an interested stockholder under the statute if the board of directors approved in advance the transaction by which he or she otherwise would have become an interested stockholder.

After the five-year prohibition, any business combination between the Maryland corporation and an interested stockholder generally must be recommended by the board of directors of the corporation and approved by the affirmative vote of at least:

- 80% of the votes entitled to be cast by holders of outstanding shares of voting stock of the corporation voting together as a single group; and
- two-thirds of the votes entitled to be cast by holders of voting stock of the corporation other than shares held by the interested stockholder with whom or with whose affiliate the business combination is to be effected or held by an affiliate or associate of the interested stockholder voting together as a single voting group.

The business combination statute may discourage others from trying to acquire control of us and increase the difficulty of consummating any offer, including potential acquisitions that might involve a premium price for our common stock or otherwise be in the best interest of our stockholders.

### **Our authorized, but unissued common and preferred stock may prevent a change in our control.**

Our charter authorizes us to issue additional authorized but unissued shares of our common stock or preferred stock. In addition, our board of directors may classify or reclassify any unissued shares of our common stock or preferred stock and may set the preferences, rights and other terms of the classified or reclassified shares. As a result, our board may establish a series of preferred stock that could delay or prevent a transaction or a change in control that might involve a premium price for our common stock or otherwise be in the best interest of our stockholders.

### **Our stockholder rights plan could inhibit a change in our control.**

We have adopted a stockholder rights agreement. Under the terms of the rights agreement, in general, if a person or group acquires more than 15% of the outstanding shares of our common stock, all of our other common stockholders will have the right to purchase securities from us at a discount to such securities' fair market value, thus causing substantial dilution to the acquiring person. The rights agreement may have the effect of inhibiting or impeding a change in control not approved by our board of directors and, therefore, could adversely affect our stockholders' ability to realize a premium over the then-prevailing market price for our common stock in connection with such a transaction. In addition, since our board of directors can prevent the rights agreement from operating, in the event our board approves of an acquiring person, the rights agreement gives our board of directors significant discretion over whether a potential acquirer's efforts to acquire a large interest in us will be successful. Because the rights agreement contains provisions that are designed to ensure that the executive officers, our manager and its affiliates will never, alone, be considered a group that is an acquiring person, the rights agreement provides the executive officers, our manager and its affiliates with certain advantages that are not available to other stockholders.

### **Our staggered board and other provisions of our charter and bylaws may prevent a change in our control.**

Our board of directors is divided into three classes of directors. Directors of each class are chosen for three-year terms upon the expiration of their current terms, and each year one class of directors is elected by the stockholders. The staggered terms of our directors may reduce the possibility of a tender offer or an attempt at a change in control, even though a tender offer or change in control might be in the best interest of our stockholders. In addition, our charter and bylaws also contain other provisions that may delay or prevent a transaction or a change in control that might involve a premium price for our common stock or otherwise be in the best interest of our stockholders.

**Our share price has fluctuated meaningfully, particularly on a percentage basis, and may fluctuate meaningfully in the future. Accordingly, you may not be able to resell your shares at or above the price at which you purchased them.**

The trading price of our common shares has fluctuated significantly over the last three years. Moreover, future share price fluctuations could likely be subject to similarly wide price fluctuations in the future in response to various factors, including:

- market conditions in the broader stock market in general, or in the REIT or real estate industry in particular;
- our ability to make investments with attractive risk-adjusted returns, including, without limitation, investments in excess MSRs or senior living facilities;
- market perception of our current and projected financial condition, potential growth, future earnings and future cash dividends;
- announcements we make regarding dividends;
- actual or anticipated fluctuations in our quarterly financial and operating results;
- market perception or media coverage of our manager or its affiliates;
- actions by rating agencies;
- short sales of our common stock;
- issuance of new or changed securities analysts' reports or recommendations;
- media coverage of us, other REITs or the outlook of the real estate industry;
- major reductions in trading volumes on the exchanges on which we operate;
- credit deterioration within our portfolio;
- legislative or regulatory developments, including changes in the status of our regulatory approvals or licenses; and
- litigation and governmental investigations.

These and other factors may cause the market price and demand for our common shares to fluctuate substantially, which may negatively affect the price or liquidity of our common shares. Moreover, the recent market conditions negatively impacted our share price and may do so in the future. When the market price of a stock has been volatile or has decreased significantly in the past, holders of that stock have, at times, instituted securities class action litigation against the company that issued the stock. If any of our shareholders brought a lawsuit against us, we could incur substantial costs defending, settling or paying any resulting judgments related to the lawsuit. Such a lawsuit could also divert the time and attention of our management from our business and hurt our share price.

**We may be unable – or elect not – to pay dividends on our common or preferred shares in the future, which would negatively impact our business in a number of ways and decrease the price of our common and preferred shares.**

While we are required to make distributions in order to maintain our REIT status (as described above under “–We may be unable to generate sufficient revenue from operations to pay our operating expenses and to pay distributions to our stockholders”), we may elect not to maintain our REIT status, in which case we would no longer be required to make such distributions. Moreover, even if we do elect to maintain our REIT status, we may elect to comply with the applicable requirements by, after completing various procedural steps, distributing, under certain circumstances, a portion of the required amount in the form of shares of our common stock in lieu of cash. If we elect not to maintain our REIT status or to satisfy any required distributions in common shares in lieu of cash, such action could negatively affect our business and financial condition as well as the price of both our common and preferred shares. No assurance can be given that we will pay any dividends on our common shares in the future.

We do not currently have unpaid accrued dividends on our preferred shares. However, to the extent we do, we cannot pay any dividends on our common shares, pay any consideration to repurchase or otherwise acquire shares of our common stock or redeem any shares of any series of our preferred stock without redeeming all of our outstanding preferred shares in accordance with the governing documentation. Consequently, the failure to pay dividends on our preferred shares restricts the actions that we may take with respect to our common shares and preferred shares. Moreover, if we do not pay dividends on any series of preferred stock for six or more periods, then holders of each affected series obtain the right to call a special meeting and elect two members to our board of directors. We cannot predict whether the holders of our preferred stock would take such action or, if taken, how long the process would take or what impact the two new directors on our board of directors would have on our company (other than increasing our director compensation costs). However, the election of additional directors would affect the composition of our board of directors and, thus, could affect the management of our business.

**We may in the future choose to pay dividends in our own stock, in which case you could be required to pay income taxes in excess of the cash dividends you receive.**

We may in the future distribute taxable dividends that are payable in cash and shares of our common stock at the election of each stockholder. Taxable stockholders receiving such dividends will be required to include the full amount of the dividend as ordinary income to the extent of our current and accumulated earnings and profits for federal income tax purposes. As a result, stockholders may be required to pay income taxes with respect to such dividends in excess of the cash dividends received. If a U.S. stockholder sells the stock that it receives as a dividend in order to pay this tax, the sale proceeds may be less than the amount included in income with respect to the dividend, depending on the market price of our stock at the time of the sale. Furthermore, with respect to certain non-U.S. stockholders, we may be required to withhold U.S. tax with respect to such dividends, including in respect of all or a portion of such dividend that is payable in stock. In addition, if a significant number of our stockholders determine to sell shares of our common stock in order to pay taxes owed on dividends, it may put downward pressure on the trading price of our common stock.

It is unclear whether and to what extent we will be able to pay taxable dividends in cash and stock. Moreover, various aspects of such a taxable cash/stock dividend are uncertain and have not yet been addressed by the IRS. No assurance can be given that the IRS will not impose additional requirements in the future with respect to taxable cash/stock dividends, including on a retroactive basis, or assert that the requirements for such taxable cash/stock dividends have not been met.

**Shares eligible for future sale may adversely affect our common stock price.**

Sales of our common stock or other securities in the public or private market, or the perception that these sales may occur, could cause the market price of our common stock to decline. This could also impair our ability to raise additional capital through the sale of our equity securities. Under our certificate of incorporation, we are authorized to issue up to 500,000,000 shares of common stock, of which 105,181,009 shares of common stock were outstanding as of December 31, 2011. We cannot predict the size of future issuances of our common stock or other securities or the effect, if any, that future sales and issuances would have on the market price of our common stock.

**An increase in market interest rates may have an adverse effect on the market price of our common stock.**

One of the factors that investors may consider in deciding whether to buy or sell shares of our common stock is our distribution rate as a percentage of our share price relative to market interest rates. If the market price of our common stock is based primarily on the earnings and return that we derive from our investments and income with respect to our investments and our related distributions to stockholders, and not from the market value of the investments themselves, then interest rate fluctuations and capital market conditions will likely affect the market price of our common stock. For instance, if market interest rates rise without an increase in our distribution rate, the market price of our common stock could decrease as potential investors may require a higher distribution yield on our common stock or seek other securities paying higher distributions or interest. In addition, rising interest rates would result in increased interest expense on our variable rate debt, thereby adversely affecting cash flow and our ability to service our indebtedness and pay distributions.

#### **Item 1B. Unresolved Staff Comments**

We have no unresolved staff comments received more than 180 days prior to December 31, 2011.

#### **Item 2. Properties.**

As of December 31, 2011, we have no material investments in properties.

Our manager leases principal executive and administrative offices located at 1345 Avenue of the Americas, New York, New York 10105. Its telephone number is (212) 798-6100.

#### **Item 3. Legal Proceedings.**

We are not a party to any material legal proceedings. No material proceedings were terminated during the fourth quarter of the fiscal year covered by this report.

#### **Item 4. Mine Safety Disclosures**

None.

## PART II

### Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities.

We have one class of common stock, which has been listed and is traded on the New York Stock Exchange (NYSE) under the symbol “NCT” since our initial public offering in October 2002. The following table sets forth, for the periods indicated, the high, low and last sale prices in dollars on the NYSE for our common stock and the distributions we declared with respect to the periods indicated.

	2011	High	Low	Last Sale	Distributions Declared
First Quarter	\$8.85	\$5.82	\$6.04	\$	-
Second Quarter	\$6.48	\$4.18	\$5.78	\$	0.10
Third Quarter	\$6.65	\$4.05	\$4.07	\$	0.15
Fourth Quarter	\$5.12	\$3.56	\$4.65	\$	0.15

	2010	High	Low	Last Sale	Distributions Declared
First Quarter	\$3.35	\$1.75	\$3.23	\$	-
Second Quarter	\$4.18	\$2.00	\$2.68	\$	-
Third Quarter	\$3.20	\$2.24	\$3.10	\$	-
Fourth Quarter	\$7.10	\$3.02	\$6.70	\$	-

We may declare quarterly distributions on our common stock. No assurance, however, can be given that any future distributions will be made or, if made, as to the amounts or timing of any future distributions as such distributions are subject to our earnings, financial condition, liquidity, capital requirements, REIT requirements and such other factors as our board of directors deems relevant.

On February 22, 2012, the closing sale price for our common stock, as reported on the NYSE, was \$5.48. As of February 22, 2012, there were approximately 73 record holders of our common stock. This figure does not reflect the beneficial ownership of shares held in nominee name.

#### *Equity Compensation Plan Information*

The following table summarizes the total number of outstanding securities in the incentive plan and the number of securities remaining for future issuance, as well as the weighted average exercise price of all outstanding securities as of December 31, 2011.

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options	Weighted Average Exercise Price of Outstanding Options	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans
<b>Equity Compensation Plans Approved by Security Holders:</b>			
Newcastle Investment Corp. Nonqualified Stock Option and Incentive Award Plan	6,813,109 (1)	\$13.02	2,013,533 (2)
<b>Equity Compensation Plans Not Approved by Security Holders:</b>			
None	N/A	N/A	N/A

- (1) Includes options for (i) 5,998,947 shares held by an affiliate of our manager; (ii) 798,162 shares granted to our manager and assigned to certain of Fortress’s employees; and (iii) an aggregate of 16,000 shares granted to our directors, other than Mr. Edens.
- (2) The maximum available for issuance is equal to 10% of the number of outstanding equity interests, subject to a maximum of 10,000,000 shares in the aggregate over the term of the plan and no award shall be granted on or after June 6, 2012 (but awards granted may extend beyond this date). The number of securities remaining available for future issuance is net of an aggregate of 130,240 shares of our common stock awards to our directors, other than Mr. Edens and Mr. Riis, representing the aggregate annual automatic stock awards to each such director for 2003 through 2011, and of 1,043,118 shares issued to our manager and its affiliates, certain of our directors, and employees of Fortress, upon the exercise of previously granted options.

## Item 6. Selected Financial Data.

The selected historical consolidated financial information set forth below as of and for each of the five years ended December 31, 2011 has been derived from our audited historical consolidated financial statements.

The information below should be read in conjunction with Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our consolidated financial statements and notes thereto included in Part II, Item 8, “Financial Statements and Supplementary Data.”

### Selected Consolidated Financial Information (in thousands, except per share data)

	Year Ended December 31,				
	2011	2010	2009	2008	2007
<b>Operating Data</b>					
Interest income	\$ 292,296	\$ 300,272	\$ 361,866	\$ 468,867	\$ 680,535
Interest expense	138,035	172,219	218,410	307,303	476,932
Net interest income	154,261	128,053	143,456	161,564	203,603
Impairment (Reversal)	677	(240,858)	548,540	2,991,830	220,321
Net interest income (loss) after impairment / reversal	153,584	368,911	(405,084)	(2,830,266)	(16,718)
Other Income (Loss)	135,790	282,287	227,399	(112,809)	(8,885)
Expenses	30,233	29,528	31,901	32,623	39,724
Income (loss) from continuing operations	259,141	621,670	(209,586)	(2,975,698)	(65,327)
Income (loss) from discontinued operations	306	(8)	(318)	(9,654)	(130)
Net income (loss)	259,447	621,662	(209,904)	(2,985,352)	(65,457)
Preferred dividends	(5,580)	(7,453)	(13,501)	(13,501)	(12,640)
Excess of carrying amount of exchanged preferred stock over fair value of consideration paid	-	43,043	-	-	-
Income (loss) applicable to common stockholders	\$ 253,867	\$ 657,252	\$ (223,405)	\$ (2,998,853)	\$ (78,097)
Income (loss) per share of common stock, diluted	\$ 3.09	\$ 10.96	\$ (4.23)	\$ (56.81)	\$ (1.52)
Income (loss) from continuing operations per share of common stock, after preferred dividends and excess of carrying amount of exchanged preferred stock over fair value of consideration paid, diluted	\$ 3.09	\$ 10.96	\$ (4.22)	\$ (56.63)	\$ (1.52)
Weighted average number of shares of common stock outstanding, diluted	81,990	59,949	52,864	52,785	51,369
Dividends declared per share of common stock	\$ 0.40	\$ -	\$ -	\$ 0.75	\$ 2.85

As Of December 31,

	2011	2010	2009	2008	2007
<b>Balance Sheet Data</b>					
<u>Non-Recourse VIE Financing Structures</u>					
Real estate securities, available-for-sale	\$ 1,479,214	\$ 1,859,984	\$ 1,784,487	\$ 1,472,253	\$ 3,507,813
Real estate related loans, held-for-sale, net	807,214	750,130	554,367	696,523	1,418,382
Residential mortgage loans, held-for-investment, net	331,236	124,974	-	-	529,975
Residential mortgage loans, held-for-sale, net	-	252,915	380,123	406,265	-
Other investments	18,883	18,883	-	-	-
Restricted cash	105,040	157,005	200,251	37,483	65,578
Total assets	3,179,324	3,612,733	3,358,877	3,050,535	5,963,778
Total debt	3,015,251	3,689,875	4,765,631	5,138,627	5,755,207
Total liabilities	3,150,683	3,875,181	4,971,677	5,474,308	5,863,916

Recourse Financing Structures and Unlevered Assets

Real estate securities, available-for-sale	252,530	600	46,308	196,495	1,328,071
Real estate related loans, held-for-sale, net	6,366	32,475	19,495	146,689	438,596
Residential mortgage loans, held-for-sale, net	2,687	298	3,524	3,367	104,630
Investments in excess mortgage servicing rights at fair value	43,971	-	-	-	-
Other investments	6,024	6,024	-	-	-
Cash and cash equivalents	157,356	33,524	68,300	49,746	55,916
Restricted cash	-	-	-	6,799	67,548
Total assets	472,475	74,378	155,751	423,088	2,073,992
Total debt	284,442	55,936	174,573	376,572	1,636,487
Total liabilities	309,027	59,515	183,603	392,847	1,726,229

Aggregate

Total assets	3,651,799	3,687,111	3,514,628	3,473,623	8,037,770
Total debt	3,299,693	3,745,811	4,940,204	5,515,199	7,391,694
Total liabilities	3,459,710	3,934,696	5,155,280	5,867,155	7,590,145
Common stockholders' equity (deficit)	130,506	(309,168)	(1,793,152)	(2,546,032)	295,125
Preferred stock	61,583	61,583	152,500	152,500	152,500

**Supplemental Balance Sheet Data**

Common shares outstanding	105,181	62,027	52,913	52,789	52,779
Book value (deficit) per share of common stock	\$ 1.24	\$ (4.98)	\$ (33.89)	\$ (48.23)	\$ 5.59

**Other Data**

Core earnings (1)	\$ 118,448	\$ 91,072	\$ 98,054	\$ 115,440	\$ 151,239
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- (1) Newcastle has five primary variables that impact its operating performance: (i) the current yield earned on its investments that are not included in non-recourse financing structures (i.e., unlevered investments and investments subject to recourse debt), (ii) the net yield it earns from its non-recourse financing structures, (iii) the interest expense and dividends incurred under its recourse debt and preferred stock, (iv) its operating expenses, and (v) its realized and unrealized gains on its investments, derivatives and debt obligations, including impairment. "Core earnings," which was referred to as "Net Interest Income Less Expenses (Net of Preferred Dividends)" in our prior filings, is a non-GAAP measure of the operating performance of Newcastle that excludes the fifth variable listed above and is equal to net interest income less expenses and preferred dividends. It is used by management to gauge the current performance of Newcastle without taking into account gains and losses, which, although they represent a part of our recurring operations, are subject to significant variability and are only a potential indicator of future economic performance. Management views this measure as Newcastle's "core" current earnings, while gains and losses (including impairment) are simply a potential indicator of future earnings. Management believes that this measure provides investors with useful information regarding Newcastle's "core" current earnings, and it enables investors to evaluate Newcastle's current performance using the same measure that management uses to operate the business.

Core earnings does not represent cash generated from operating activities in accordance with GAAP and therefore should not be considered an alternative to net income as an indicator of our operating performance or as an alternative to cash flow as a measure of our liquidity and is not necessarily indicative of cash available to fund cash needs. For a further description of the differences between cash flow provided by operating activities and net income, see Part II, Item 7, "Management's Discussed Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources" below. Our calculation of core earnings may be different from the calculation used by other companies and, therefore, comparability may be limited. Set forth below is a reconciliation of core earnings to the most directly comparable GAAP financial measure.

Calculation of core earnings:

	Year Ended December 31,				
	2011	2010	2009	2008	2007
Income (loss) applicable to common stockholders	\$ 253,867	\$ 657,252	\$ (223,405)	\$ (2,998,853)	\$ (78,097)
Add (deduct):					
Impairment (reversal)	677	(240,858)	548,540	2,991,830	220,321
Other (income) loss	(135,790)	(282,287)	(227,399)	112,809	8,885
(Income) loss from discontinued operations	(306)	8	318	9,654	130
Excess of carrying amount of exchanged preferred stock over fair value of consideration paid	-	(43,043)	-	-	-
Core earnings	\$ 118,448	\$ 91,072	\$ 98,054	\$ 115,440	\$ 151,239

## Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following should be read in conjunction with our consolidated financial statements and notes thereto included in Part II, Item 8, "Financial Statements and Supplementary Data," and Part I, Item 1A, "Risk Factors."

### General

Newcastle Investment Corp. is a real estate investment and finance company. We invest in, and actively manage, a portfolio of real estate securities, loans, excess mortgage servicing rights ("excess MSRs") and other real estate related assets. Our objective is to maximize the difference between the yield on our investments and the cost of financing these investments while hedging our interest rate risk. We emphasize portfolio management, asset quality, liquidity, diversification, match funded financing and credit risk management.

As described below, our operating results and book value improved meaningfully during 2011.

We currently own a diversified portfolio of credit sensitive real estate debt investments, including securities, loans and excess MSRs. Our portfolio of real estate securities includes commercial mortgage backed securities (CMBS), senior unsecured debt issued by REITs, real estate related asset backed securities (ABS) and FNMA/FHLMC securities. Mortgage backed securities are interests in or obligations secured by pools of mortgage loans. We generally target investments rated A through BB, except for our FNMA/FHLMC securities which have an implied AAA rating. We also own, directly and indirectly, interests in loans and pools of loans, including real estate related loans, commercial mortgage loans, residential mortgage loans, manufactured housing loans and subprime mortgage loans.

We employ leverage as part of our investment strategy. We do not have a predetermined target debt to equity ratio as we believe the appropriate leverage for the particular assets we are financing depends on the credit quality of those assets. As of December 31, 2011, we had complied with the general investment guidelines adopted by our board of directors that limit total leverage. We utilize leverage for the sole purpose of financing our portfolio and not for the purpose of speculating on changes in interest rates.

We strive to maintain access to a broad array of capital resources in an effort to insulate our business from potential fluctuations in the availability of capital. We seek to utilize multiple forms of financing including collateralized debt obligations (CDOs), other securitizations, term loans, and trust preferred securities, as well as short term financing in the form of loans and repurchase agreements. As we discuss in more detail under "– Market Considerations" below, while market conditions have improved meaningfully since 2008, the current conditions continue to reduce the array of capital resources available to us and have made the terms of capital resources we are able to obtain generally less favorable to us relative to the terms we were able to obtain prior to the onset of challenging conditions. Specifically, the economic environment and capital markets have become volatile in the latter half of 2011. That said, we have recently been able to access more types of capital – and on better terms – than we had been able to access during 2008 and 2009.

We seek to match fund our investments with respect to interest rates and maturities in order to reduce the impact of interest rate fluctuations on earnings and reduce the risk of refinancing our liabilities prior to the maturity of the investments. We seek to finance a substantial portion of our real estate securities and loans through the issuance of term debt, which generally represents obligations issued in multiple classes secured by an underlying portfolio of assets. Specifically, our CDO financings offer us the structural flexibility to buy and sell certain investments to manage risk and, subject to certain limitations, to optimize returns.

We conduct our business through the following segments: (i) investments financed with non-recourse collateralized debt obligations ("non-recourse CDOs"), (ii) unlevered investments in deconsolidated Newcastle CDO debt ("unlevered CDOs"), (iii) unlevered excess MSRs, (iv) investments financed with other non-recourse debt ("non-recourse other"), (v) investments and debt repurchases financed with recourse debt ("recourse"), (vi) other unlevered investments ("unlevered other") and (vii) corporate. With respect to the non-recourse CDOs and non-recourse other segments, Newcastle is generally entitled to receive net cash flows from these structures on a periodic basis. Revenues attributable to each segment, as restated for previously reported periods, are disclosed below (in thousands).

For the Year Ended	Non-Recourse CDOs	Unlevered CDOs	Unlevered Excess MSRs	Non-Recourse Other	Recourse	Unlevered Other	Corporate	Inter-segment Elimination	Total
December 31, 2011	\$ 218,131	\$ 344	\$ 1,260	\$ 73,364	\$ 2,234	\$ 2,636	\$ 167	\$ (5,840)	\$ 292,296
December 31, 2010	\$ 226,717	\$ -	\$ -	\$ 72,773	\$ 976	\$ 1,653	\$ 68	\$ (1,915)	\$ 300,272
December 31, 2009	\$ 275,938	\$ -	\$ -	\$ 76,868	\$ 7,416	\$ 1,543	\$ 101	\$ -	\$ 361,866

## **Taxation**

We have elected to be taxed as a real estate investment trust, or REIT, under the Internal Revenue Code of 1986, as amended (the "Code"), and we intend to continue to operate in such a manner. Our current and continuing qualification as a REIT depends on our ability to meet various tax law requirements, including, among others, requirements relating to the sources of our income, the nature of our assets, the composition of our stockholders, and the timing and amount of distributions that we make. A portion of the REIT distribution requirements may be able to be satisfied through stock dividends rather than cash, subject to limitations based on the value of the stock.

As a REIT, we will generally not be subject to U.S. federal corporate income tax on that portion of our income that is distributed to stockholders if we distribute at least 90% of our REIT taxable income to our stockholders by prescribed dates and comply with various other requirements. We may, however, nevertheless be subject to certain state, local and foreign income and other taxes, and to U.S. federal income and excise taxes and penalties in certain situations, including taxes on our undistributed income. In addition, our stockholders may be subject to state, local or foreign taxation in various jurisdictions, including those in which they transact business or reside. The state, local and foreign tax treatment of us and our stockholders may not conform to the U.S. federal income tax treatment.

If, in any taxable year, we fail to satisfy one or more of the various tax law requirements, we could fail to qualify as a REIT. If we fail to qualify as a REIT for a particular tax year, our income in that year would be subject to U.S. federal corporate income tax (including any applicable alternative minimum tax), and we may need to borrow funds or liquidate certain investments in order to pay the applicable tax, or we may not be able to pay it. Unless entitled to relief under certain statutory provisions, we would also be disqualified from treatment as a REIT for the four taxable years following the year during which qualification is lost. Moreover, if we fail to qualify as a REIT, we would be delisted from the NYSE.

Although we currently intend to operate in a manner designed to qualify as a REIT, it is possible that economic, market, legal, tax or other developments may cause us to fail to qualify as a REIT, or may cause our board of directors to revoke the REIT election, including certain potential developments discussed in Part I, Item 1A, "Risk Factors."

## **Market Considerations**

### *Financial Markets in which We Operate*

Our ability to generate income is dependent on our ability to invest our capital on a timely basis at attractive levels. The two primary market factors that affect our ability to do this are (1) credit spreads and (2) the availability of financing on favorable terms.

Generally speaking, widening credit spreads reduce any unrealized gains on our current investments (or cause or increase unrealized losses) and increase our costs for new financings, but increase the yields available on potential new investments, while tightening credit spreads increase the unrealized gains (or reduce unrealized losses) on our current investments and reduce our costs for new financings, but reduce the yields available on potential new investments. By reducing unrealized gains (or causing unrealized losses), widening credit spreads also impact our ability to realize gains on existing investments if we were to sell such assets.

From mid-2007 through early 2009, credit spreads widened substantially. One of the key drivers of the widening of credit spreads over these years was the continued disruption and liquidity concerns throughout the credit markets. The severity and scope of the disruption intensified meaningfully during the fourth quarter of 2008 and the first quarter of 2009. In the latter part of 2009, credit spreads tightened substantially and continued to tighten in 2010 and the first half of 2011. However, credit spreads have widened in the second half of 2011, reflecting the currently challenging economic environment. These changes in credit spreads caused the net unrealized losses on our securities and derivatives to decrease from 2009 through early 2011 and became net unrealized gains. However, this trend reversed during the second half of 2011. Market conditions remain challenging, could change rapidly, and we cannot predict how recent or future changes in market conditions will affect our business.

We utilize multiple forms of financing, depending on their appropriateness and availability, to finance our investments, including collateralized debt obligations (CDOs) or other securitizations, private or public offerings of debt, term loans, trust preferred securities, and short-term financing in the form of loans and repurchase agreements. One component of our investment strategy is to use match funded financing structures, such as CDOs, at rates that provide a positive net spread relative to our investment returns.

Recent conditions in the credit markets have impaired our ability to match fund investments. During the past two years, financing in the form of securitizations or other long-term non-recourse structures not subject to margin requirements was generally not available or economical, and it remains difficult to obtain under current market conditions. Lenders have generally tightened their underwriting standards and increased their margin requirements, resulting in a decline in the

overall amount of leverage available to us and an increase in our borrowing costs. These conditions make it highly likely that we will have to use less efficient forms of financing for any new investments, which will likely require a larger portion of our cash flows to be put toward making the initial investment and thereby reduce the amount of cash available for distribution to our stockholders and funds available for operations and investments, and which will also likely require us to assume higher levels of risk when financing our investments. Moreover, financial market conditions remain volatile and have been adversely affected by the unrest in the Middle East, the earthquake in Japan, the European financial crisis, continuing weakness in the U.S. job market and concern about the United States' level of indebtedness. Volatility in equity markets could impair our ability to raise debt or equity capital or otherwise finance our business.

We believe that the current environment has created an attractive opportunity to invest in MSRs. Specifically:

- changes in the regulatory treatment of MSRs for financial institutions subject to Basel III, a revision to the global regulatory capital and liquidity framework for banks, which will impose increased regulatory capital costs on banks for owning MSRs;
- elevated borrower delinquencies and defaults experienced over the last few years, and increased regulatory oversight, has led to substantially higher costs for mortgage servicers and negatively impacted their profitability; and
- mortgage servicing has become less attractive to many financial institutions due to increasingly negative publicity and heightened government and regulatory scrutiny.

These dynamics resulted in a pipeline of MSRs for sale by banks and non-bank servicers, as these institutions are under pressure to exit or reduce their exposure to the mortgage servicing business. As a result, we believe that this relative oversupply of MSRs, combined with a historically low interest rate environment and a challenging credit market, have contributed to an availability of MSRs that are attractively priced. We closed on our first investment in excess MSRs in December 2011 and are exploring opportunities to acquire additional MSRs that provide attractive risk-adjusted returns.

#### *Liquidity*

Credit and liquidity conditions improved during 2010 and 2011. The onset of the challenging credit and liquidity conditions during the financial crisis have adversely affected us and the markets in which we operate in a number of ways. For example, these conditions have reduced the market trading activity for many real estate securities and loans, resulting in less liquid markets for those securities and loans. As the securities held by us and many other companies in our industry are marked to market at the end of each quarter, the decreased liquidity and concern over market conditions have resulted in significant reductions in mark to market valuations of many real estate securities and loans and the collateral underlying them, as well as volatility and uncertainty with respect to such valuations. These lower valuations, and decreased expectations of future cash flows, have affected us by, among other things:

- decreasing our net book value;
- contributing to our decision to record significant impairment charges; and
- reducing the amount, which we refer to as “cushion,” by which we satisfy the over collateralization and interest coverage tests of our CDOs (sometimes referred to as CDO “triggers”) or contributing to several of our CDOs failing their over collateralization tests (see “– Liquidity and Capital Resources” and “– Debt Obligations” below).

Failed CDO triggers, impairments resulting from incurred losses, and asset sales made at prices significantly below face amount while the related debt is being repaid at its full face amount, as well as the retention of cash, could further contribute to reductions in future earnings, cash flow and liquidity.

With respect to dividends, we have paid all dividends on our preferred stock through January 31, 2012. In order to maintain liquidity, we elected not to declare any dividends on our common stock from late 2008 through early 2011. However, based on the above described improvements in the markets over the last two years, and the corresponding improvement in our financial condition and liquidity, we elected to declare a quarterly dividend of \$0.10 per common share for the second quarter of 2011, and a quarterly dividend of \$0.15 per common share for each of the third and fourth quarters of 2011. Dividends on our common shares are paid at the beginning of the quarter succeeding the quarter to which they relate. We may elect to adjust or not to pay any future dividend payments to reflect our current and expected cash from operations or to satisfy future liquidity needs.

#### *Extent of Market Disruption*

Market conditions have meaningfully improved over the last few years, but it is not clear whether a sustained recovery will occur or, if so, for how long it will last. We do not currently know the full extent to which the continuing challenging

market conditions will affect us or the markets in which we operate. If such conditions persist, particularly with respect to commercial real estate, we may experience additional impairment charges, potential reductions in cash flows from our investments and additional challenges in raising capital and obtaining investment or other financing on attractive terms. Moreover, we will likely need to continue to place a high priority on managing our liquidity. Certain aspects of these effects are more fully described in Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Interest Rate, Credit and Spread Risk” and “– Liquidity and Capital Resources” as well as in Part II, Item 7A, “Quantitative and Qualitative Disclosures About Market Risk.”

## Formation and Organization

We were formed and completed our initial public offering in 2002.

The following table presents information on shares of our common stock issued since our formation:

Year	Shares Issued	Range of Issue Prices (1)	Net Proceeds (millions)
Formation - 2006	45,713,817		
2007	7,065,362	\$27.75-\$31.30	\$201.3
2008	9,871	N/A	\$0.1
2009	123,463	N/A	\$0.1
2010	9,114,671	\$3.13	\$28.5
2011	43,153,825	\$4.55 - \$6.00	\$210.8
December 31, 2011	<u>105,181,009</u>		

- (1) Excludes prices of shares issued pursuant to the exercise of options and of shares issued to our independent directors. Includes prices of shares issued in exchange for preferred stock.

As of December 31, 2011, approximately 4.8 million of our shares of common stock were held by Fortress, through its affiliates, and principals of Fortress. In addition, Fortress, through its affiliates, held options to purchase approximately 6.0 million shares of our common stock at December 31, 2011.

## Application of Critical Accounting Policies

Management’s discussion and analysis of financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”). The preparation of financial statements in conformity with GAAP requires the use of estimates and assumptions that could affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities and the reported amounts of revenue and expenses. Actual results could differ from these estimates. Management believes that the estimates and assumptions utilized in the preparation of the consolidated financial statements are prudent and reasonable. Actual results historically have been in line with management’s estimates and judgments used in applying each of the accounting policies described below, as modified periodically to reflect current market conditions. A summary of our significant accounting policies is presented in Note 2 to our consolidated financial statements, which appear in Part II, Item 8, “Financial Statements and Supplementary Data.” The following is a summary of our accounting policies that are most effected by judgments, estimates and assumptions.

### *Variable Interest Entities*

Variable interest entities (“VIEs”) are defined as entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. A VIE is required to be consolidated by its primary beneficiary, and only by its primary beneficiary, which is defined as the party who has the power to direct the activities of a VIE that most significantly impact its economic performance and who has the obligation to absorb losses or the right to receive benefits from the VIE that could potentially be significant to the VIE.

The VIEs in which we have a significant interest include (i) our CDOs, and (ii) our manufactured housing loan financing structures. Our CDOs were all consolidated under prior guidance; however, under current guidance, which became effective January 1, 2010, we do not have the power to direct the relevant activities of CDO V, as a result of an event of default which allows us to be removed as collateral manager of this CDO and prevents us from purchasing or selling certain collateral within this CDO, and therefore we have deconsolidated this CDO as of June 17, 2011. Similar events of default in the future, if they occur, could cause us to deconsolidate additional financing structures. Our manufactured housing loan financing structures were consolidated under prior guidance and continue to be consolidated under the current guidance. However, we completed two securitization transactions to refinance our Manufactured Housing Loans Portfolios I and II. We analyzed the securitizations under the applicable accounting guidance and concluded that the securitization transactions

should be accounted for as secured borrowings. As a result, we continue to recognize the portfolios of manufactured housing loans as pledged assets, which have been classified as loans held-for-investment at securitization, and recorded the notes issued to third parties as secured borrowings.

Our subprime securitizations are also considered VIEs, but we do not control their activities and no longer receive a significant portion of their returns. These subprime securitizations were not consolidated under the current or prior guidance.

In addition, our investments in CMBS, CDO securities and loans may be deemed to be variable interests in VIEs, depending on their structure. We are not obligated to provide, nor have we provided, any financial support to these VIEs. We monitor these investments and, to the extent we determine that we potentially own a majority of the currently controlling class, analyze them for potential consolidation. As of December 31, 2011, we have not consolidated these potential VIEs due to the determination that, based on the nature of our investments and the provisions governing these structures, we do not have the power to direct the activities that most significantly impact their economic performance.

We will continue to analyze future investments, as well as reconsideration events in existing entities, pursuant to the VIE requirements. These analyses require considerable judgment in determining the primary beneficiary of a VIE since they involve estimated probability weighting of subjectively determined possible cash flow scenarios. The result could be the consolidation of an entity that would otherwise not have been consolidated or the non-consolidation of an entity that would otherwise have been consolidated.

#### *Valuation and Impairment of Securities*

We have classified all our real estate securities as available for sale. As such, they are carried at fair value with net unrealized gains or losses reported as a component of accumulated other comprehensive income, to the extent impairment losses are considered temporary as described below. Fair value may be based upon broker quotations, counterparty quotations or pricing services quotations, which provide valuation estimates based upon reasonable market order indications or a good faith estimate thereof and are subject to significant variability based on market conditions, such as interest rates, credit spreads and market liquidity. A significant portion of our securities are currently not traded in active markets and therefore have little or no price transparency. For a further discussion of this trend, see “– Market Considerations” above. As a result, we have estimated the fair value of these illiquid securities based on internal pricing models rather than the sources described above. The determination of estimated cash flows used in pricing models is inherently subjective and imprecise. Changes in market conditions, as well as changes in the assumptions or methodology used to determine fair value, could result in a significant and immediate increase or decrease in our book equity. For securities valued with pricing models, these inputs include the discount rate, assumptions relating to prepayments, default rates and loss severities, as well as other variables.

See Note 7 to our consolidated financial statements in Part II, Item 8, “Financial Statements and Supplementary Data” for information regarding the fair value of our investments, and its estimation methodology, as of December 31, 2011.

Our securities must be categorized by the “level” of inputs used in estimating their fair values. Level 1 would be assets valued based on quoted prices for identical instruments in active markets. We have no level 1 assets. Level 2 would be assets valued based on quoted prices in active markets for similar instruments, on quoted prices in less active or inactive markets, or on other “observable” market inputs. Level 3 would be assets valued based significantly on “unobservable” market inputs. We have further broken level 3 into level 3A, third party indications, and level 3B, internal models. Fair value under GAAP represents an exit price in the normal course of business, not a forced liquidation price. If we were forced to sell assets in a short period to meet liquidity needs, the prices we receive could be substantially less than the recorded fair values.

We generally classify the broker and pricing service quotations we receive as level 3A inputs, except for certain liquid securities. They are quoted prices in generally inactive and illiquid markets for identical or similar securities. These quotations are generally received via email and contain disclaimers which state that they are “indicative” and not “actionable” – meaning that the party giving the quotation is not bound to actually purchase the security at the quoted price. These quotations are generally based on models prepared by the brokers, and we have little visibility into the inputs they use. Based on quarterly procedures we have performed with respect to quotations received from these brokers, including comparison to the outputs generated from our internal pricing models and transactions we have completed with respect to these securities, as well as on our knowledge and experience of these markets, we have generally determined that these quotes represent a reasonable estimate of fair value. For the \$1.5 billion carrying value of securities valued using quotations as of December 31, 2011, a 100 basis point change in credit spreads would impact estimated fair value by approximately \$50.7 million.

Our estimation of the fair value of level 3B assets (as described below) involves significant judgment. We validated the inputs and outputs of our models by comparing them to available independent third party market parameters and models for reasonableness. We believe the assumptions we used are within the range that a market participant would use and factor in the liquidity conditions currently in the markets. In comparison to the prior year end, we have generally used lower discount rates as inputs to our models for ABS and CMBS-large loan/single borrower securities in order to reflect current market conditions. The other inputs to our models, including prepayment speeds, default rates and severity assumptions, have generally remained consistent with the assumptions used at the prior year end, other than certain modifications we have made to reflect conditions relevant to specific assets.

Similar changes to assumptions were made in 2010. In 2009, Newcastle generally lowered the prepayment assumptions based on observed reductions in actual prepayment speeds and slower expected future prepayments consistent with market projections. The slower prepayments were the result of increasing difficulties for borrowers to refinance, caused by a tightening of underwriting standards, decline in home prices, contraction of available lenders due to bank failures and a distressed securitization market. Default assumptions were increased due to higher levels of delinquent underlying loans. Loss severity assumptions were increased based on observed increases in recent loss severities that have been driven by falling home prices and the increasing number of foreclosures or distressed home sales in the residential sector and higher losses as a result of the increasing number of foreclosures and bankruptcies of borrowers experienced in the commercial sector. The discount rate assumption used to value subprime and other asset backed securities was generally decreased as a result of increased liquidity in the market.

For CMBS and ABS securities valued with internal models, which have an aggregate fair value of \$249.5 million as of December 31, 2011, a 10% unfavorable change in our assumptions would result in the following decreases in such aggregate fair value (in thousands):

	CMBS	ABS
Outstanding face amount	\$ 374,030	\$ 162,617
Fair value	\$ 180,100	\$ 69,400
Effect on fair value with 10% unfavorable change in:		
Discount rate	\$ (6,637)	\$ (2,594)
Prepayment rate	N/A	\$ (791)
Default rate	\$ (8,016)	\$ (5,382)
Loss severity	\$ (7,117)	\$ (8,668)

The sensitivity analysis is hypothetical and should be used with caution. In particular, the results are calculated by stressing a particular economic assumption independent of changes in any other assumption; in practice, changes in one factor may result in changes in another, which might counteract or amplify the sensitivities. Also, changes in the fair value based on a 10% variation in an assumption generally may not be extrapolated because the relationship of the change in the assumption to the change in fair value may not be linear.

We must also assess whether unrealized losses on securities, if any, reflect a decline in value which is other-than-temporary and, if so, write the impaired security down to its fair value through earnings. A decline in value is deemed to be other-than-temporary if (i) it is probable that we will be unable to collect all amounts due according to the contractual terms of a security which was not impaired at acquisition (there is an expected credit loss), or (ii) if we have the intent to sell a security in an unrealized loss position or it is more likely than not we will be required to sell a security in an unrealized loss position prior to its anticipated recovery (if any). For the purposes of performing this analysis, we assume the anticipated recovery period is until the respective security's expected maturity. Also, for certain securities which represent "beneficial interests in securitized financial assets," whenever there is a probable adverse change in the timing or amounts of estimated cash flows of a security from the cash flows previously projected, an other-than-temporary impairment is considered to have occurred. These securities are also analyzed for other-than-temporary impairment under the guidelines applicable to all securities as described herein. We note that primarily all of our securities, except our FNMA/FHLMC securities, fall within the definition of beneficial interests in securitized financial assets.

Temporary declines in value generally result from changes in market factors, such as market interest rates and credit spreads, or from certain macroeconomic events, including market disruptions and supply changes, which do not directly impact our ability to collect amounts contractually due. We continually evaluate the credit status of each of our securities and the collateral supporting our securities. This evaluation includes a review of the credit of the issuer of the security (if applicable), the credit rating of the security, the key terms of the security (including credit support), debt service coverage and loan to value ratios, the performance of the pool of underlying loans and the estimated value of the collateral supporting such loans, including the effect of local, industry and broader economic trends and factors. These factors include loan default expectations and loss severities, which are analyzed in connection with a particular security's credit support, as well as prepayment rates. These factors are also analyzed in relation to the amount of the unrealized loss and the period elapsed since it was incurred. The result of this evaluation is considered when determining management's estimate of cash flows,

particularly with respect to developing the necessary inputs and assumptions. Each security is impacted by different factors and in different ways; generally the more negative factors which are identified with respect to a given security, the more likely we are to determine that we do not expect to receive all contractual payments when due with respect to that security. Significant judgment is required in this analysis.

As of December 31, 2011, we had 80 securities with a carrying amount of \$243.8 million that had been downgraded during 2011 and recorded a net other-than-temporary impairment charge of \$1.7 million on these securities in 2011. However, we do not depend on credit ratings in underwriting our securities, either at acquisition or on an ongoing basis. As mentioned above, a credit rating downgrade is one factor that we monitor and consider in our analysis regarding other-than-temporary impairment, but it is not determinative. Our securities generally benefit from the support of one or more subordinate classes of securities or equity or other forms of credit support. Therefore, credit rating downgrades, even to the extent they relate to an expectation that a securitization we have invested in, on an overall basis, has credit issues, may not ultimately impact cash flow estimates for the class of securities in which we are invested.

Furthermore, the analysis of whether it is more likely than not that we will be required to sell securities in an unrealized loss position prior to an expected recovery in value (if any), the amount of such expected required sales, and the projected identification of which securities would be sold is also subject to significant judgment, particularly in times of market illiquidity such as we are currently experiencing.

#### *Revenue Recognition on Securities*

Income on these securities is recognized using a level yield methodology based upon a number of cash flow assumptions that are subject to uncertainties and contingencies. Such assumptions include the rate and timing of principal and interest receipts (which may be subject to prepayments and defaults). These assumptions are updated on at least a quarterly basis to reflect changes related to a particular security, actual historical data, and market changes. These uncertainties and contingencies are difficult to predict and are subject to future events, and economic and market conditions, which may alter the assumptions. For securities acquired at a discount for credit losses, we recognize the excess of all cash flows expected over our investment in the securities as Interest Income on a “loss-adjusted” yield basis. The loss-adjusted yield is determined based on an evaluation of the credit status of securities, as described in connection with the analysis of impairment above.

#### *Valuation of Derivatives*

Similarly, our derivative instruments are carried at fair value. Fair value is based on counterparty quotations. Newcastle reports the fair value of derivative instruments gross of cash paid or received pursuant to credit support agreements and fair value is reflected on a net counterparty basis when Newcastle believes a legal right of offset exists under an enforceable netting agreement. To the extent they qualify as cash flow hedges, net unrealized gains or losses are reported as a component of accumulated other comprehensive income; otherwise, the net unrealized gains and losses are reported currently in income. To the extent they qualify as fair value hedges, net unrealized gains or losses on both the derivative and the related portion of the hedged item are reported currently in income. Fair values of such derivatives are subject to significant variability based on many of the same factors as the securities discussed above, including counterparty credit risk. The results of such variability, the effectiveness of our hedging strategies and the extent to which a forecasted hedged transaction remains probable of occurring, could result in a significant increase or decrease in our GAAP equity and/or earnings.

#### *Impairment of Loans*

We own, directly and indirectly, real estate related, commercial mortgage and residential mortgage loans, including manufactured housing loans and subprime mortgage loans. To the extent that they are classified as held for investment, we must periodically evaluate each of these loans or loan pools for possible impairment. Impairment is indicated when it is deemed probable that we will be unable to collect all amounts due according to the contractual terms of the loan, or, for loans acquired at a discount for credit losses, when it is deemed probable that we will be unable to collect as anticipated. Upon determination of impairment, we would establish a specific valuation allowance with a corresponding charge to earnings. We continually evaluate our loans receivable for impairment. Our residential mortgage loans, including manufactured housing loans, are aggregated into pools for evaluation based on like characteristics, such as loan type and acquisition date. Individual loans are evaluated based on an analysis of the borrower’s performance, the credit rating of the borrower, debt service coverage and loan to value ratios, the estimated value of the underlying collateral, the key terms of the loan, and the effect of local, industry and broader economic trends and factors. Pools of loans are also evaluated based on similar criteria, including historical and anticipated trends in defaults and loss severities for the type and seasoning of loans being evaluated. This information is used to estimate specific impairment charges on individual loans as well as provisions for estimated unidentified incurred losses on pools of loans. Significant judgment is required both in determining impairment and in estimating the resulting loss allowance. Furthermore, we must assess our intent and ability to hold our

loan investments on a periodic basis. If we do not have the intent to hold a loan for the foreseeable future or until its expected payoff, the loan must be classified as “held for sale” and recorded at the lower of cost or estimated value.

#### *Revenue Recognition on Loans Held for Investment*

Income on these loans is recognized similarly to that on our securities and is subject to similar uncertainties and contingencies, which are also analyzed on at least a quarterly basis. For loans acquired at a discount for credit losses, the net income recognized is based on a “loss adjusted yield” whereby a gross interest yield is recorded to Interest Income, offset by a provision for probable, incurred credit losses which is accrued on a periodic basis to Valuation Allowance. The provision is determined based on an evaluation of the loans as described under “– Impairment of Loans” above. A rollforward of the allowance is included in Note 5 to our consolidated financial statements in Part II, Item 8, “Financial Statements and Supplementary Data.”

#### *Revenue Recognition on Investments in Excess Mortgage Servicing Rights*

Investments in excess MSR are aggregated into pools as applicable; each pool of excess MSR is accounted for in the aggregate. Excess MSR are accreted into interest income on an effective yield or “interest” method, based upon the expected excess servicing income through the expected life of the underlying mortgages. Changes to expected cash flows result in a cumulative retrospective adjustment, which will be recorded in the period in which the change in expected cash flows occurs. Under the retrospective method, the interest income recognized for a reporting period would be measured as the difference between the amortized cost basis at the end of the period and the amortized cost basis at the beginning of the period, plus any cash received during the period. The amortized cost basis is calculated as the present value of estimated future cash flows using an effective yield, which is the yield that equates all past actual and current estimated future cash flows to the initial investment. In addition, our policy is to recognize interest income only on excess MSR in existing eligible underlying mortgages. The difference between the fair value of excess MSR and their amortized cost basis is recorded as “Other Income” or “Other Losses”, as applicable. Fair value is generally determined by discounting the expected future cash flows using discount rates that incorporate the market risks and liquidity premium specific to the excess MSR, and therefore may differ from their effective yields.

For excess MSR valued with internal models as of December 31, 2011, a 10% unfavorable change in our assumptions would result in the following decreases in fair value (in thousands):

Fair value	\$ 43,971
Effect on fair value with 10% unfavorable change in:	
Discount rate	\$ (1,892)
Prepayment rate	\$ (1,799)
Constant default rate	\$ (500)
Delinquency rate	\$ (481)
Recapture rate	\$ (1,086)

The sensitivity analysis is hypothetical and should be used with caution. In particular, the results are calculated by stressing a particular economic assumption independent of changes in any other assumption; in practice, changes in one factor may result in changes in another, which might counteract or amplify the sensitivities. Also, changes in the fair value based on a 10% variation in an assumption generally may not be extrapolated because the relationship of the change in the assumption to the change in fair value may not be linear.

#### *Revenue Recognition on Loans Held for Sale*

Real estate related, commercial mortgage and residential mortgage loans that are considered held for sale are carried at the lower of amortized cost or market value determined on either an individual method basis, or in the aggregate for pools of similar loans. Interest income is recognized based on the loan’s coupon rate to the extent management believes it is collectable. Purchase discounts are not amortized as interest income during the period the loan is held for sale. A change in the market value of the loan, to the extent that the value is not above the cost basis, is recorded in Valuation Allowance. A rollforward of the allowance is included in Note 5 to our consolidated financial statements in Part II, Item 8, “Financial Statements and Supplementary Data.”

### *Recent Accounting Pronouncements*

In April 2009, the FASB issued new guidance which (i) requires disclosures about the fair value of financial instruments on an interim basis, (ii) changes the guidance for determining, recording and disclosing other-than-temporary impairment, and (iii) provides additional guidance for estimating fair value when the volume or level of activity for an asset or liability have significantly decreased. This guidance was effective for Newcastle as of April 1, 2009. It had a significant impact on our disclosures, but no material impact on our financial condition, liquidity, or results of operations upon adoption. A reclassification adjustment of \$1.3 billion of loss from Accumulated Deficit to Accumulated Other Comprehensive Income (Loss) was recorded at adoption but had no net effect on equity. Post-adoption impairment determinations are performed using this new guidance and may result in materially different conclusions than would have been reached under prior guidance.

In June 2009, the FASB issued new guidance on transfers of financial assets, which eliminates the concept of qualified special purpose entities (“QSPEs”), changes the requirements for reporting a transfer of a portion of financial assets as a sale, clarifies other sale accounting criteria and changes the initial measurement of a transferor’s interest in transferred financial assets. Furthermore, it requires additional disclosures. This guidance is effective for fiscal years beginning after November 15, 2009. The adoption of this guidance did not have a material impact on our financial position, liquidity or results of operations.

In June 2009, the FASB issued new guidance which changes the definition of a variable interest entity (“VIE”) and changes the methodology to determine who is the primary beneficiary of, or in other words who consolidates, a VIE. Furthermore, it eliminates the scope exception for QSPEs, which are now subject to the VIE consolidation rules. This guidance is effective for fiscal years beginning after November 15, 2009. Generally, the changes are expected to cause more entities to be defined as VIEs and to require consolidation by the entity that exercises day-to-day control over a VIE, such as servicers and collateral managers. As discussed under “– Variable Interest Entities” above, this guidance resulted in changes in our consolidated entities. Changes to consolidation conclusions impact, potentially materially, our gross assets, liabilities, equity, revenues and expenses but are not material to the net income applicable to our common stockholders.

In May 2011, the FASB issued new guidance regarding the measurement and disclosure of fair value, which will become effective for us on January 1, 2012. We have not yet completed our assessment of the potential impact of this guidance.

In June 2011, the FASB issued a new accounting standard that eliminates the current option to report other comprehensive income and its components in the statement of stockholders’ equity. Instead, an entity will be required to present items of net income and other comprehensive income in one continuous statement or in two separate, but consecutive, statements. We have early-adopted this accounting standard and have opted to present two separate statements.

The FASB has recently issued or discussed a number of proposed standards on such topics as consolidation, the definition of an investment company, financial statement presentation, revenue recognition, leases, financial instruments, hedging, and contingencies. Some of the proposed changes are significant and could have a material impact on Newcastle’s reporting. Newcastle has not yet fully evaluated the potential impact of these proposals, but will make such an evaluation as the standards are finalized.

## Results of Operations

The following tables summarize the changes in our results of operations from year-to-year (dollars in thousands):

### Comparison of Results of Operations for the years ended December 31, 2011 and 2010

	Year Ended December 31,		Increase (Decrease)	
	2011	2010	Amount	%
Interest income	\$ 292,296	\$ 300,272	\$ (7,976)	(2.7%)
Interest expense	138,035	172,219	(34,184)	(19.8%)
Net interest income	154,261	128,053	26,208	20.5%
<b>Impairment</b>				
Valuation allowance (reversal) on loans	(15,163)	(339,887)	324,724	95.5%
Other-than-temporary impairment on securities, net	15,840	99,029	(83,189)	(84.0%)
	677	(240,858)	241,535	100.3%
Net interest income (loss) after impairment	153,584	368,911	(215,327)	(58.4%)
<b>Other Income (Loss)</b>				
Gain (loss) on settlement of investments, net	78,181	52,307	25,874	49.5%
Gain on extinguishment of debt	66,110	265,656	(199,546)	(75.1%)
Other income (loss), net	(8,501)	(35,676)	27,175	76.2%
	135,790	282,287	(146,497)	(51.9%)
<b>Expenses</b>				
Loan and security servicing expense	4,649	4,580	69	1.5%
General and administrative expense	7,295	7,696	(401)	(5.2%)
Management fee to affiliate	18,289	17,252	1,037	6.0%
	30,233	29,528	705	2.4%
Income (loss) from continuing operations	\$ 259,141	\$ 621,670	\$ (362,529)	(58.3%)

## Interest Income

Interest income decreased by \$8.0 million during the year ended December 31, 2011 compared to the year ended December 31, 2010 primarily due to (i) a \$12.6 million decrease in interest income as a result of the deconsolidation of CDO V in June 2011, (ii) a \$6.6 million decrease in prepayment penalties we received as a result of the lower volume of the prepayment of securities and loans in the year ended December 31, 2011, offset by (iii) an \$11.2 million increase in interest income as a result of new investments made, partially offset by paydowns and changes in interest rates.

## Interest Expense

Interest expense decreased by \$34.2 million primarily due to (i) a \$7.6 million decrease in interest expense attributable to the deconsolidation of CDO V, (ii) a \$5.8 million decrease in interest expense on debt as a result of the paydowns and repurchases of our CDO debt obligations, (iii) a \$16.6 million decrease in interest expense on derivatives as a result of the termination of interest rate swaps, decreases in swap notional amounts and changes in interest rates and (iv) a \$6.5 million decrease in the amortization of deferred hedge losses. The decreases described in (i) to (iv) above were partially offset by a \$2.3 million increase in interest expense on other bonds payable and repurchase agreements due to the refinancing of our manufactured housing loan portfolios and a higher outstanding balance of repurchase agreement financing on our FNMA/FHLMC securities.

## Valuation Allowance (Reversal) on Loans

The valuation allowance (reversal) on loans changed by \$324.7 million primarily due to (i) a significantly larger net increase in fair values, by \$278.0 million, on our real estate related loans during the year ended December 31, 2010 compared to the year ended December 31, 2011 as a result of market conditions improving more in the 2010 period than in the 2011 period and (ii) a larger net reversal of valuation allowance on our manufactured housing loans and residential mortgage loans, by \$46.7 million, in the 2010 period compared to 2011 period due to the reclassification of our manufactured housing loan portfolio I, manufactured housing loan portfolio II and residential mortgage loans from held-for-sale to held-for-investment in April 2010, May 2011 and September 2011, respectively. This change in fair values and the reclassification impacted the amount of valuation allowance we were able to reverse during those periods.

In addition, the reversal of previously established valuation allowances will likely decline over time as the reversal is subject to (i) a continued improvement in loan valuations and (ii) the amount of previously established allowances that have not yet been reversed.

#### **Other-than-temporary Impairment on Securities, Net**

The other-than-temporary impairment on securities decreased by \$83.2 million primarily due to improved market conditions. We recorded an impairment charge of \$15.8 million on 30 securities during the year ended December 31, 2011, compared to an impairment charge of \$99.0 million on 115 securities during the year ended December 31, 2010.

#### **Gain (Loss) on Settlement of Investments, Net**

The net gain on settlement of investments increased by \$25.9 million as a result of the increased volume of sales and repayments of investments. We recorded a net gain of \$78.2 million on 95 securities, loans and derivatives that were sold, paid off or terminated during the year ended December 31, 2011, compared to a net gain of \$52.3 million on 65 securities, loans and derivatives that were sold, paid off or terminated during the year ended December 31, 2010.

#### **Gain (Loss) on Extinguishment of Debt**

The gain on extinguishment of debt decreased by \$199.5 million due to a lower face amount and a higher average price of debt repurchased in the year ended December 31, 2011 compared to the year ended December 31, 2010.

We repurchased \$171.8 million face amount of our own CDO debt and other bond payable at an average price of 61.2% of par during the year ended December 31, 2011 compared to \$483.7 million face amount of CDO bonds repurchased at an average price of 44.6% of par during the year ended December 31, 2010.

#### **Other Income (Loss), Net**

Other loss decreased by \$27.2 million primarily due to (i) a \$22.0 million decrease in unrealized losses recognized on certain interest rate swap agreements, which were de-designated as accounting hedges as the hedged items were no longer probable of occurring, (ii) a \$4.5 million increase in fair value of certain non-hedge derivative instruments and (iii) a \$2.0 million increase in management fees, included in Other Income, in 2011 related to our acquisition of the collateral management rights with respect to certain C-BASS CBOs in February 2011. The decreases in other loss were partially offset by a \$1.5 million increase in hedge ineffectiveness recognized on certain interest rate swap agreements and a \$0.2 million increase in other income.

#### **Loan and Security Servicing Expense**

Loan and security servicing expense remained relatively stable during the year ended December 31, 2011 compared to the year ended December 31, 2010.

#### **General and Administrative Expense**

General and administrative expense decreased by \$0.4 million primarily due to a \$0.9 million decrease in directors and officers liability insurance expense, offset by a net \$0.5 million increase in legal and professional fees due to the acquisition of excess MSR investments and public offerings in the year ended December 31, 2011.

#### **Management Fee to Affiliate**

Management fees increased by \$1.0 million during the year ended December 31, 2011 compared to the year ended December 31, 2010 due to a net increase in gross equity as a result of our public offerings of common stock in March 2011 and September 2011, partially offset by the return of capital distributions made on our preferred stock in 2010.

Comparison of Results of Operations for the years ended December 31, 2010 and 2009

	Year Ended December 31,		Increase (Decrease)	
	2010	2009	Amount	%
Interest income	\$ 300,272	\$ 361,866	\$ (61,594)	(17.0%)
Interest expense	172,219	218,410	(46,191)	(21.1%)
Net interest income	128,053	143,456	(15,403)	(10.7%)
<b>Impairment</b>				
Valuation allowance (reversal) on loans	(339,887)	15,007	(354,894)	N.M
Other-than-temporary impairment on securities, net	99,029	533,533	(434,504)	N.M
	(240,858)	548,540	(789,398)	N.M
Net interest income (loss) after impairment	368,911	(405,084)	773,995	N.M
<b>Other Income (Loss)</b>				
Gain (loss) on settlement of investments, net	52,307	11,438	40,869	357.3%
Gain on extinguishment of debt	265,656	215,279	50,377	23.4%
Other income (loss), net	(35,676)	682	(36,358)	N.M
	282,287	227,399	54,888	24.1%
<b>Expenses</b>				
Loan and security servicing expense	4,580	5,034	(454)	(9.0%)
General and administrative expense	7,696	8,899	(1,203)	(13.5%)
Management fee to affiliate	17,252	17,968	(716)	(4.0%)
	29,528	31,901	(2,373)	(7.4%)
Income (loss) from continuing operations	\$ 621,670	\$ (209,586)	\$ 831,256	396.6%

N.M. - Not meaningful

**Interest Income**

Interest income decreased by \$61.6 million primarily due to (i) a \$23.1 million decrease as a result of the deconsolidation of CDO VII, (ii) a \$2.2 million decrease as a result of the disposition of securities and loans, (iii) a \$5.1 million decrease due to paydowns of existing securities and loans, (iv) a \$1.0 million decrease in the amount of prepayment penalties we received as a result of the prepayment of securities and loans, and (v) a \$40.9 million decrease due to the accretion of discounts on securities impaired due to non-credit factors recognized as interest income in the first quarter of 2009. Up until March 31, 2009, GAAP required us to record impairments to write down debt securities to their fair value, rather than just the portion related to expected credit losses. As a result, we recorded a significant amount of impairments due to non-credit factors prior to 2009. Therefore, the portion of non-credit impairment, which we expected to recover, contributed to a significant amount of interest income being recorded through the accretion of discount in the first quarter of 2009. However, upon the adoption of revised impairment guidance issued by the FASB effective April 1, 2009, we no longer had to record impairment due to non-credit factors and therefore no longer recorded this significant increase in accretion income after the first quarter of 2009. The decreases described in items (i) through (v) above were partially offset by a \$10.7 million net increase as a result of new investments made offset by interest rate changes.

**Interest Expense**

Interest expense decreased by \$46.2 million primarily due to (i) a \$3.3 million decrease as a result of the repayment of repurchase agreements in connection with the disposition or repayment of certain securities and loans and a \$6.7 million decrease in connection with the repurchase or paydown of CDO debt obligations, (ii) an \$18.5 million decrease as a result of the deconsolidation of CDO VII, (iii) a \$3.1 million decrease due to the repayment of debt resulting from paydowns of existing securities and loans, (iv) a \$4.3 million decrease in the interest expense incurred on our junior subordinated notes due to the modification and exchanges effected in April 2009 and January 2010, (v) a \$5.3 million decrease due to changes in the amortization of a deferred hedge loss and (vi) a \$5.1 million net decrease, which was primarily due to changes in interest rates.

### **Valuation Allowance on Loans**

The valuation allowance on loans decreased by \$354.9 million primarily due to improved market conditions, certain successful loan restructurings and the sales of loans at prices substantially above their carrying value, resulting in a larger net reversal of valuation allowances on loans during the year ended December 31, 2010.

### **Other-than-temporary Impairment on Securities, Net**

The other-than-temporary impairment on securities decreased by \$434.5 million primarily due to improved market conditions.

### **Gain (Loss) on Settlement of Investments, Net**

The net gain on settlement of investments increased by \$40.9 as a result of the increased volume of sales and repayments of investments at a gain and the lower volume of sales of certain securities and loans at a loss due to liquidity reasons in the year ended December 31, 2010 compared to the year ended December 31, 2009.

### **Gain (Loss) on Extinguishment of Debt**

The net gain on extinguishment of debt increased by \$50.4 million primarily due to the significantly higher amounts of debt repurchased (although at lower discounts to our basis, such discounts are based on market conditions as well as the level within the capital structure we are repurchasing) in the year ended December 31, 2010 compared to the year ended December 31, 2009.

### **Other Income (Loss), Net**

Other income decreased by \$36.4 million primarily due to (i) a \$20.6 million increase in unrealized loss recognized on derivative instruments for which the hedged items were no longer probable of occurring (ii) a \$16.7 million decrease in fair value of certain non-hedge derivative instruments, offset by (iii) a \$0.9 million increase in miscellaneous fee income.

### **Loan and Security Servicing Expense**

Loan and security servicing expense has remained relatively stable during the year ended December 31, 2010 compared to the year ended December 31, 2009.

### **General and Administrative Expense**

General and administrative expense decreased by \$1.2 million primarily due to a decrease in legal and professional expenses.

### **Management Fee to Affiliate**

Management fees decreased by \$0.7 million primarily due to a reduction in gross equity (as defined in the management agreement) as a result of the exchange of preferred stock in the first quarter of 2010.

### **Liquidity and Capital Resources**

#### *Overview*

Liquidity is a measurement of our ability to meet potential cash requirements, including ongoing commitments to repay borrowings, fund and maintain investments, and other general business needs. Additionally, to maintain our status as a REIT under the Code, we must distribute annually at least 90% of our REIT taxable income. We note that we believe we have already met this requirement through 2011 and that a portion of this requirement may be able to be met in future years through stock dividends, rather than cash, subject to limitations based on the value of our stock. Our primary sources of funds for liquidity consist of net cash provided by operating activities, sales or repayments of investments, potential refinancing of existing debt, and the issuance of equity securities, when feasible. We have an effective shelf registration statement with the SEC, which allows us to issue common stock, preferred stock, depository shares, debt securities and warrants. Our debt obligations are generally secured directly by our investment assets, except for the junior subordinated notes payable.

### *Sources of Liquidity and Uses of Capital*

As of the date of this filing, we have sufficient liquid assets, which include unrestricted cash and FNMA/FHLMC securities, to satisfy all of our short-term recourse liabilities. Our junior subordinated notes payable are long-term obligations. With respect to the next twelve months, we expect that our cash on hand combined with our cash flow provided by operations will be sufficient to satisfy our anticipated liquidity needs with respect to our current investment portfolio, including related financings, hedging activity, potential margin calls and operating expenses. While it is inherently more difficult to forecast beyond the next twelve months, we currently expect to meet our long-term liquidity requirements, specifically the repayment of our recourse debt obligations, through our cash on hand and, if needed, additional borrowings, proceeds received from repurchase agreements and similar financings, and the liquidation or refinancing of our assets.

These short-term and long-term expectations are forward-looking and subject to a number of uncertainties and assumptions, which are described below under “–Factors That Could Impact Our Liquidity, Capital Resources and Capital Obligations” as well as Part I, Item 1A, “Risk Factors.” If our assumptions about our liquidity prove to be incorrect, we could be subject to a shortfall in liquidity in the future, and this short-fall may occur rapidly and with little or no notice, which would limit our ability to address the shortfall on a timely basis.

Cash flow provided by operations constitutes a critical component of our liquidity. Essentially, our cash flow provided by operations is equal to (i) the net cash flow from our CDOs that have not failed their over collateralization or interest coverage tests, plus (ii) the net cash flow from our non-CDO investments that are not subject to mandatory debt repayment, including principal and sales proceeds, less (iii) operating expenses (primarily management fees, professional fees and insurance), and less (iv) interest on the junior subordinated notes payable.

Our cash flow provided by operations differs from our net income (loss) due to these primary factors: (i) accretion of discount or premium on our real estate securities and loans (including the accrual of interest and fees payable at maturity), discount on our debt obligations, deferred financing costs, and deferred hedge gains and losses, (ii) gains and losses from sales of assets financed with CDOs, (iii) the valuation allowance recorded in connection with our loan assets, as well as other-than-temporary impairment on our securities, (iv) unrealized gains or losses on our non-hedge derivatives, (v) the non-cash gains or charges associated with our early extinguishment of debt, and (vi) net income (loss) generated within CDOs that have failed their over collateralization or interest coverage tests. Proceeds from the sale of assets which serve as collateral for our CDO financings, including gains thereon, are required to be retained in the CDO structure until the related bonds are retired and are, therefore, not available to fund current cash needs outside of these structures.

### *Update on Liquidity, Capital Resources and Capital Obligations*

Certain details regarding our liquidity, current financings and capital obligations as of February 29, 2012 are set forth below:

- *Cash* – We had a total of \$285.5 million of cash, comprised of \$152.1 million of unrestricted cash and \$133.4 million of restricted cash held for reinvestment in our CDOs;
- *Margin Exposure and Recourse Financings* – We have margin exposure on a \$7.8 million repurchase agreement related to the financing of the Newcastle Class I-MM notes (of which only \$1.9 million is recourse) and a \$227.7 million repurchase agreement related to the financing of FNMA/FHLMC securities.

The following table compares our recourse financings excluding the junior subordinated notes (in thousands):

<u>Recourse Financings</u>	<u>February 29, 2012</u>	<u>December 31, 2011</u>	<u>December 31, 2010</u>
CDO Securities	\$ 1,946	\$ 2,182	\$ 4,683
Non-FNMA/FHLMC recourse financings	1,946	2,182	4,683
FNMA/FHLMC securities	227,650	231,012	-
Total recourse financings	<u>\$ 229,596</u>	<u>\$ 233,194</u>	<u>\$ 4,683</u>

The non-FNMA/FHLMC recourse financings and the FNMA/FHLMC recourse financing will mature in June 2012 and March 2012, respectively.

It is important for readers to understand that our liquidity, available capital resources and capital obligations could change rapidly due to a variety of factors, many of which are beyond our control. Set forth below is a discussion of some of the factors that could impact our liquidity, available capital resources and capital obligations.

### *Factors That Could Impact Our Liquidity, Capital Resources and Capital Obligations*

We refer readers to our discussions in other sections of this report for the following information:

- For a further discussion of recent trends and events affecting our liquidity, see “– Market Considerations” above;

- As described above, under “– Update on Liquidity, Capital Resources and Capital Obligations,” we are subject to margin calls in connection with our repurchase agreements;
- Our match funded investments are financed long term, and their credit status is continuously monitored, which is described under "Quantitative and Qualitative Disclosures About Market Risk — Interest Rate Exposure" below. Our remaining investments, generally financed with short term debt or short term repurchase agreements, are also subject to refinancing risk upon the maturity of the related debt. See “– Debt Obligations” below; and
- For a further discussion of a number of risks that could affect our liquidity, access to capital resources and our capital obligations, see Part I, Item 1A, “Risk Factors” above.

In addition to the information referenced above, the following factors could affect our liquidity, access to capital resources and our capital obligations. As such, if their outcomes do not fall within our expectations, changes in these factors could negatively affect our liquidity.

- *Access to Financing from Counterparties* – Decisions by investors, counterparties and lenders to enter into transactions with us will depend upon a number of factors, such as our historical and projected financial performance, compliance with the terms of our current credit and derivative arrangements, industry and market trends, the availability of capital and our investors’, counterparties’ and lenders’ policies and rates applicable thereto, and the relative attractiveness of alternative investment or lending opportunities. Recent conditions and events have limited the array of capital resources available to us and made the terms of capital resources we are able to obtain generally less favorable to us relative to the terms we were able to obtain prior to the onset of challenging conditions. Our business strategy is dependent upon our ability to finance our real estate securities, loans and other real estate related assets at rates that provide a positive net spread. Currently, spreads for such liabilities have widened relative to historical levels and demand for such liabilities remains lower than the demand prior to the onset of challenging market conditions.
- *Impact of Rating Downgrades on CDO Cash Flows* – Ratings downgrades of assets in our CDOs can negatively impact compliance with the CDOs’ over collateralization tests. Generally, the over collateralization test measures the principal balance of the specified pool of assets in a CDO against the corresponding liabilities issued by the CDO. However, based on ratings downgrades, the principal balance of an asset or of a specified percentage of assets in a CDO may be deemed to be reduced below their current balance to levels set forth in the related CDO documents for purposes of calculating the over collateralization test. As a result, ratings downgrades can reduce the assumed principal balance of the assets used in the over collateralization test relative to the corresponding liabilities in the test, thereby reducing the over collateralization percentage. In addition, actual defaults of assets would also negatively impact compliance with the over collateralization tests. Failure to satisfy an over collateralization test could result in the redirection of cashflows, or, in certain cases, in the potential removal of Newcastle as collateral manager of the affected CDO. See “– Debt Obligations” below for a summary of assets on negative watch for possible downgrade in our CDOs.
- *Impact of Expected Repayment or Forecasted Sale on Cash Flows* – The timing of and proceeds from the repayment or sale of certain investments may be different than expected or may not occur as expected. Proceeds from sales of assets in the current illiquid market environment are unpredictable and may vary materially from their estimated fair value and their carrying value.

### *Investment Portfolio*

Our investment portfolio as of December 31, 2011 is detailed in Part I, Item 1, “Business – Our Investment Strategy.”

In December 2011, we made our first investment in excess mortgage servicing rights. We invested \$44 million to acquire a 65% interest in the excess mortgage servicing rights of a \$9.9 billion residential mortgage portfolio. Nationstar, a leading residential mortgage servicer that is externally managed by our manager, is the servicer of the loans and invested alongside Newcastle by acquiring the remaining 35% interest in the excess mortgage servicing rights. To the extent any loans in this portfolio are refinanced by Nationstar, subject to certain limitations, we are entitled to receive our pro rata share of the excess mortgage servicing rights of the refinanced loans. We will not have any servicing duties, advance obligations or liabilities associated with the portfolio.

## Debt Obligations

Our debt obligations, as summarized in Note 8 to Part II, Item 8, “Financial Statements and Supplementary Data,” existing at December 31, 2011 (gross of \$4.8 million of discounts) had contractual maturities as follows (in thousands):

	Nonrecourse	Recourse	Total
2012	\$ 6,546	\$ 233,194	\$ 239,740
2013	-	-	-
2014	-	-	-
2015	-	-	-
2016	-	-	-
Thereafter	3,013,717	51,004	3,064,721
Total	<u>\$ 3,020,263</u>	<u>\$ 284,198</u>	<u>\$ 3,304,461</u>

Certain of the debt obligations included above are obligations of our consolidated subsidiaries which own the related collateral. In some cases, including the CDO and Other Bonds Payable, such collateral is not available to other creditors of ours.

Our non-CDO obligations contain various customary loan covenants. We were in compliance with all of the covenants in our non-CDO financings as of December 31, 2011.

The following table provides additional information regarding short-term borrowings. In 2011, these short-term borrowings were used to finance our investments in FNMA/FHLMC securities and the purchase of certain notes issued by Newcastle CDO VI. In prior years, these short-term borrowings were used to finance certain of our investments in real estate securities and loans, including FNMA/FHLMC securities and our investments in manufactured housing loans. The FNMA/FHLMC repurchase agreements have full recourse to Newcastle and the CDO VI repurchase agreement has recourse to Newcastle for up to twenty-five percent of the outstanding balance of the repurchase facility, which was approximately \$2.2 million as of December 31, 2011. The weighted average difference between the face amount of assets and the face amount of available financing for the FNMA/FHLMC repurchase agreements and the CDO VI repurchase agreement were 5% and 40%, respectively, during the year ended December 31, 2011. Margin calls are based on the fair value of the collaterals (dollars in thousands).

	Three Months Ended December 31, 2011				Year Ended December 31, 2011		
	Outstanding	Average		Weighted	Average		Weighted
	Balance at	Daily	Maximum		Daily	Maximum	
	December 31,	Amount	Amount	Average	Amount	Amount	Average
	2011	Outstanding	Outstanding	Interest Rate	Outstanding	Outstanding	Interest Rate
Repurchase agreements	\$ 239,740	\$ 219,987	\$ 242,074	0.41%	\$ 150,692	\$ 242,074	0.45%

In March 2006, we acquired a portfolio of subprime mortgage loans (“Subprime Portfolio I”) for \$1.50 billion. In April 2006, Newcastle Mortgage Securities Trust 2006-1 (“Securitization Trust 2006”) closed on a securitization of Subprime Portfolio I. We do not consolidate Securitization Trust 2006. We sold Subprime Portfolio I to Securitization Trust 2006, which issued \$1.45 billion of notes with a stated maturity of March 2036. We, as holder of the equity of Securitization Trust 2006, have the option to redeem the notes once the aggregate principal balance of Subprime Portfolio I is equal to or less than 20% of such balance at the date of the transfer. The transaction between us and Securitization Trust 2006 qualified as a sale for accounting purposes. However, 20% of the loans which are subject to a call option by us were not treated as being sold. Following the securitization, we held the following interests in Subprime Portfolio I: (i) the equity of Securitization Trust 2006, (ii) the retained notes, and (iii) subprime mortgage loans subject to call option and related financing in the amount of 100% of such loans (we note that this interest is non-economic if we do not exercise the option, meaning that it has no impact on us). As of December 31, 2011, the equity was valued at zero and the retained notes had a carrying value of \$1.2 million.

In March 2007, we entered into an agreement to acquire a portfolio of subprime mortgage loans (“Subprime Portfolio II”) with up to \$1.7 billion of unpaid principal balance. In July 2007, Newcastle Mortgage Securities Trust 2007-1 (“Securitization Trust 2007”) closed on a securitization of Subprime Portfolio II. As a result of the repurchase of delinquent loans by the seller, as well as borrower repayments, the unpaid principal balance of the portfolio upon securitization was \$1.1 billion. We do not consolidate Securitization Trust 2007. We sold Subprime Portfolio II to Securitization Trust 2007, which issued \$1.0 billion of notes with a stated maturity of April 2037. We, as holder of the equity of Securitization Trust 2007, have the option to redeem the notes once the aggregate principal balance of Subprime Portfolio II is equal to or less than 10% of such balance at the date of the transfer. The transaction between us and Securitization Trust 2007 qualified as a sale for accounting purposes. However, 10% of the loans which are subject to a call option by us were not treated as being

sold. Following the securitization, we held the following interests in Subprime Portfolio II: (i) the equity of Securitization Trust 2007, (ii) the retained notes, and (iii) subprime mortgage loans subject to call option and related financing in the amount of 100% of such loans (we note that this interest is non-economic, meaning that if we do not exercise the option it has no impact on us). As of December 31, 2011, the equity and retained notes had a zero carrying value.

We have no obligation to repurchase any loans from either of our subprime securitizations. Therefore, it is expected that our exposure to loss is limited to the carrying amount of our retained interests in the securitization entities, as described above. A subsidiary of Newcastle gave limited representations and warranties with respect to Subprime Portfolio II; however, it has no assets and does not have recourse to the assets of Newcastle.

During 2011, we repurchased \$171.8 million face amount of CDO bonds and notes payable for \$105.2 million and recorded a gain of \$66.1 million. During 2010, we repurchased \$483.7 million face amount of CDO bonds for \$215.8 million and recorded a gain of \$265.7 million. During 2009, we repurchased \$246.7 million face amount of CDO bonds for \$29.9 million and recorded a gain of \$215.3 million.

On April 30, 2009, we entered into an exchange agreement with several collateralized debt obligations managed by a third party pursuant to which we agreed to exchange newly issued junior subordinated notes due in 2035 with an initial aggregate principal amount of \$101.7 million (the "Notes") for \$100 million in aggregate liquidation amount of trust preferred securities that were previously issued by a subsidiary of us (the "TRUPs") and were owned by the third party. The Notes accrue interest at a rate of 1.0% per year for a maximum of six quarters, beginning on February 1, 2009 and the aggregate principal amount of the Notes will increase to \$104.9 million by July 31, 2010. Subsequent to that period, the rate reverts to that which we were required to pay on the TRUPs (7.574% through April 2016 and at a floating rate of 3-month LIBOR plus 2.25% thereafter). In conjunction with the exchange, the TRUPs were cancelled. This exchange is considered a troubled debt restructuring under GAAP which requires us to account for the effect of the interest modification prospectively and to record expenses related to the modification immediately through earnings.

On January 29, 2010, Newcastle entered into an Exchange Agreement, dated as of January 29, 2010 (the "Exchange Agreement"), with Taberna Capital Management, LLC and certain of its affiliates (collectively, "Taberna"), pursuant to which Newcastle and Taberna agreed to exchange (the "Exchange") approximately \$52.1 million aggregate principal amount of junior subordinated notes due 2035 for approximately \$37.6 million face amount of previously issued CDO securities and approximately \$9.7 million of cash held by Newcastle. In other words, \$52.1 million face amount of Newcastle's debt, in the form of junior subordinated notes payable, was repurchased and extinguished for GAAP purposes in exchange for (i) the payment of \$9.7 million of cash, and (ii) the reissuance of \$37.6 million face amount of CDO bonds payable (which had previously been repurchased by Newcastle). In connection with the Exchange, Newcastle paid or reimbursed \$0.6 million of expenses incurred by Taberna, various indenture trustees and their respective advisors in accordance with the terms of the Exchange Agreement. Newcastle accounted for this exchange as a troubled debt restructuring involving partial repayment of debt. As a result, Newcastle recorded no gain or loss. The following table presents certain information regarding the Exchange as of the date of the Exchange (dollars in thousands).

	Repurchased junior subordinated notes	Consideration		
		Cash	Reissued CDO bonds	Total
Outstanding face amount	\$ 52,094	\$ 9,715	\$ 37,625	\$ 47,340
Weighted average coupon	7.574% (A)	N/A	LIBOR + 0.66% (B)	
Maturity	April 2035		June 2052	
Collateral	General credit of Newcastle		Assets within the respective CDOs	

(A) LIBOR + 2.25% after April 2016

(B) Weighted average effective interest rate of approximately LIBOR+0.35% after the Exchange.

The fair value of the consideration paid approximated the fair value of the repurchased junior subordinated notes of \$16.7 million.

On April 15, 2010, Newcastle completed a securitization transaction to refinance its Manufactured Housing Loans Portfolio I (the "Portfolio"). Newcastle sold approximately \$164.1 million outstanding principal balance of manufactured housing loans to Newcastle MH I LLC (the "2010 Issuer"). The 2010 Issuer issued approximately \$134.5 million aggregate principal amount of asset-backed notes, of which \$97.6 million was sold to third parties and \$36.9 million was sold to certain CDOs managed and consolidated by Newcastle. At the closing of the securitization transaction, Newcastle used the gross proceeds received from the issuance of the notes to repay the previously existing financing on this portfolio in full, terminate the related interest rate swap contracts, pay the related transaction costs and increase its unrestricted cash by approximately \$14 million. Under the applicable accounting guidance, the securitization transaction is accounted for as a

secured borrowing. As a result, no gain or loss is recorded for the transaction. Newcastle continues to recognize the portfolio of manufactured housing loans as pledged assets, which have been classified as loans held for investment at securitization, and records the notes issued to third parties as a secured borrowing. The associated assets, liabilities, revenues and expenses are presented in the non-recourse financing structure sections of the consolidated financial statements.

In December 2010, Newcastle, together with one or more of its wholly owned subsidiaries, completed a series of transactions whereby we repurchased approximately \$257 million current principal balance of Newcastle CDO VI Class I-MM notes at a price of 67.5% of par. The purchased notes represent all of the outstanding Class I-MM notes of Newcastle CDO VI (the "notes"). We purchased the notes using a combination of restricted cash, unrestricted cash and proceeds from a new repurchase facility, entered into in connection with the purchase of a portion of the notes. As of December 31, 2011, the repurchase agreement had an outstanding balance of \$8.7 million, which was secured by \$29.1 million current principal balance of the notes. Although the repurchase facility contains mark to market provisions that require margin to be posted in the event that the value of the notes decreases, the recourse to Newcastle is limited to twenty-five percent of the then-outstanding balance of the repurchase facility, which was approximately \$2.2 million as of December 31, 2011. The repurchase facility matures in June 2012 and bears interest at a rate of LIBOR + 1.75%. In accordance with GAAP, we recorded an \$82 million gain on the extinguishment of this debt and \$24.0 million of mark-to-market loss on the related interest rate swap agreement in 2010.

On May 4, 2011, we completed a securitization transaction to refinance Manufactured Housing Loans Portfolio II. We sold approximately \$197.0 million outstanding principal balance of manufactured housing loans to Newcastle Investment Trust 2011-MH 1 (the "2011 Issuer"), an indirect wholly-owned subsidiary of Newcastle. The 2011 Issuer issued approximately \$159.8 million aggregate principal amount of investment grade notes, of which \$142.8 million was sold to third parties and \$17.0 million was sold to one of the CDOs managed and consolidated by us. In addition, we retained the below investment grade notes and residual interest. As a result, we invested approximately \$20.0 million of unrestricted cash in the new securitization structure. The notes issued to third parties had an average expected maturity of 3.8 years and bore interest at an average rate of 3.23% per annum at issuance. At the closing of the securitization transaction, we used the gross proceeds received from the issuance of the notes to repay the previously existing debt in full, terminate the related interest rate swap contracts and pay the related transaction costs. Under the applicable accounting guidance, the securitization transaction is accounted for as a secured borrowing. As a result, no gain or loss is recorded for the transaction. We continue to recognize the portfolio of manufactured housing loans as pledged assets, which have been classified as loans held-for-investment at securitization, and record the notes issued to third parties as a secured borrowing. The associated assets, liabilities, revenues and expenses are presented in the non-recourse financing structure sections of the consolidated financial statements.

During 2011, we purchased \$251.5 million principal balance of FNMA/FHLMC securities (primarily one-year ARM)s for approximately \$263.8 million, using \$13.5 million of unrestricted cash and financed with \$250.3 million of repurchase agreements. These repurchase agreements have an aggregate outstanding balance of \$231.0 million at December 31, 2011, bear interest at 0.43%, mature in February 2012, and are subject to customary margin provisions.

Each of our CDO financings contains tests that measure the amount of over collateralization and excess interest in the transaction. At issuance, each of our CDOs passed all of these tests. Failure to satisfy these tests would generally cause (or has caused) the cash flow that would otherwise be distributed to the more junior classes of securities (including those held by Newcastle) to be redirected to pay down the most senior class of securities outstanding until the tests are satisfied. As a result, our cash flow and liquidity are negatively impacted upon such a failure, and the impact could be (and has been) material. The table set forth below presents data, including the most recent quarterly cash flows received by Newcastle, for each of our CDOs, and sets forth which of the CDOs have satisfied these tests in the most recent quarter. The amounts set forth are as of December 31, 2011 unless otherwise noted (dollars in thousands). For those CDOs that have failed their applicable over collateralization tests, the impact of failing is already reflected in the cash flow set forth in the table. For those CDOs that have satisfied their applicable over collateralization tests, we could potentially lose substantially all of the cash flows from those CDOs in future quarters if we fail to satisfy the tests in the future. The amounts in the table reflect data at the CDO level and thus are different from the GAAP balance sheet due to intercompany amounts eliminated in Newcastle's consolidated balance sheet (in thousands).

	CDO IV		CDO VI		CDO VIII		CDO IX		CDO X	
<u>Balance Sheet:</u>										
Assets Face Amount	\$ 215,121	\$ 246,967	\$ 917,041	\$ 795,068	\$ 1,384,509					
Assets Fair Value	186,049	151,326	646,727	609,446	1,013,638					
Issued Debt Face Amount (1)	111,895	120,732	648,633	530,125	1,204,250					
Derivative Net Liabilities Fair Value (1)	6,761	22,272	17,647	-	69,705					
<u>Cash Receipts:</u>										
Quarterly net cash receipts (2)	\$ 389	\$ 150	\$ 5,800	\$ 5,798	\$ 4,915					
<u>Collateral Composition (3):</u>										
CMBS	Face \$ 140,340	Fair Value \$ 118,379	Face \$ 138,877	Fair Value \$ 100,318	Face \$ 149,492	Fair Value \$ 70,724	Face \$ 80,101	Fair Value \$ 758,729	Face \$ 1,006,996	Fair Value \$ 758,729
REIT Debt	43,617	45,129	54,200	54,696	-	-	-	39,576	39,576	35,470
ABS	19,727	13,023	52,109	14,839	77,804	56,910	3,232	2,952	225,464	160,297
Bank Loans	1,705	1,449	1,781	1,514	205,312	133,261	163,071	110,228	28,913	6,587
Mezzanine Loans / B-Notes /										
Whole Loans	9,732	8,069	-	-	392,683	329,373	386,878	314,288	-	-
CDO	-	-	-	-	91,750	26,865	76,312	26,158	51,591	20,586
Residential Loans	-	-	-	-	-	-	3,779	3,401	-	-
Other Investments	-	-	-	-	-	-	18,883	18,883	-	-
Cash for Reinvestment	-	-	-	-	-	-	62,812	62,812	31,969	31,969
Total	\$ 215,121	\$ 186,049	\$ 246,967	\$ 151,326	\$ 917,041	\$ 646,727	\$ 795,068	\$ 609,446	\$ 1,384,509	\$ 1,013,638
Collateral on Negative Watch (4)	\$ 15,900	\$ 29,248	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 83,052	\$ -
<u>CDO Cash Flow Triggers (5):</u>										
Over Collateralization (6):										
As of Dec-2011 remittance										
Cushion (Deficit) (\$)	\$ (4,622)	\$(174,289)	\$ 55,614	\$ 84,174	\$ 84,174	\$ 96,025				
As of Feb-2012 remittance										
Cushion (Deficit) (\$)	--	(173,482)	52,033	120,286	120,286	93,265				
<u>Interest Coverage (6):</u>										
As of Dec-2011 remittance										
Cushion (Deficit) (%)	44.5%	(28.0%)	345.9%	359.9%	359.9%	289.5%				
As of Feb-2012 remittance										
Cushion (Deficit) (%)	--	(45.2%)	353.6%	360.1%	360.1%	289.5%				
<u>CDO Overview:</u>										
Effective										
Reinvestment Period End (7)	Sep-04	Aug-05	Mar-07	Jul-07	Dec-07					
Optional Call (8)	Passed	Passed	Passed	May-12	Jul-12					
Auction Call (9)	Mar-14	Apr-15	Nov-16	May-17	Jul-17					
WA Debt Spread (bps) (10)	75	45	48	58	36					

See footnotes on next page

- (1) Includes only CDO bonds issued to third parties and held by Newcastle's consolidated CDOs.
- (2) Represents net cash received from each CDO based on all of our interests in such CDO (including senior management fees but excluding principal received from senior CDO bonds owned by Newcastle) for the three months ended December 31, 2011. Cash receipts for this period included \$1.5 million of senior CDO collateral management fees, and may not be indicative of cash receipts for subsequent periods. Excluded from the quarterly net cash receipts was \$8.8 million of unrestricted cash received from principal repayments on senior CDO bonds owned by Newcastle. This cash represents a return of principal and the realization of the difference between par and the discounted purchase price of these bonds. See "Cautionary Note Regarding Forward Looking Statements" for risks and uncertainties that could cause our receipts for subsequent periods to differ materially from these amounts.
- (3) Collateral composition is calculated as a percentage of the face amount of collateral and includes CDO bonds of \$210.6 million and other bonds and notes payable of \$103.3 million issued by Newcastle, and bank loans of \$118.0 million, collateralized by Newcastle CDO VI bonds, real estate properties and a third party CDO security, which are eliminated in consolidation. The fair value of these CDO bonds, other bonds and notes payable, and bank loans was \$67.8 million, \$81.8 million, and \$91.9 million at December 31, 2011, respectively. Also reflected are weighted average credit ratings, which were determined by third party rating agencies as of a particular date, may not be current and are subject to change at any time.
- (4) Represents the face amount of collateral on negative watch for possible downgrade by at least one rating agency (Moody's, S&P, or Fitch) as of the determination date in December 2011 for CDO IV, as this CDO only reports actual over collateralization excess percentages on a quarterly basis, and as of the latest determination date in February 2012 for all other CDOs. The amount does not include any bonds issued by Newcastle, which are eliminated in consolidation and not reflected in our investment portfolio disclosure.
- (5) Each of our CDO financings contains tests that measure the amount of over collateralization and excess interest in the transaction. Failure to satisfy these tests would cause the principal and/or interest cashflow that would otherwise be distributed to more junior classes of securities (including those held by Newcastle) to be redirected to pay down the most senior class of securities outstanding until the tests are satisfied. As a result, our cash flow and liquidity are negatively impacted upon such a failure, and the impact could be material. Each CDO contains tests at various over collateralization and interest coverage percentage levels. The trigger percentages used above represent the first threshold at which cashflows would be redirected as described in this footnote. The data presented is as of the most recent remittance date on or before December 31, 2011 or February 29, 2012, as applicable, and may change or have changed subsequent to that date. CDO IV only reports on a quarterly basis and, therefore, no updated February 2012 information is available. In addition, our CDOs may also contain specific over collateralization tests that, if failed, can result in the occurrence of an event of default or our being removed as collateral manager of the CDO. Failure of the over collateralization tests can also cause a "phantom income" issue if cash that constitutes income is diverted to pay down debt instead of being distributed to us. As of the December 2011 remittance date for CDO IV and as of the February 2012 remittance date for CDO VI, these CDOs were not in compliance with their applicable over collateralization tests and, consequently, we were not receiving cash flows from these CDOs (other than senior management fees and cash flows on senior classes of bonds we own). Based upon our current calculations, we expect these portfolios to remain out of compliance for the foreseeable future. Moreover, given current market conditions, it is possible that all of our CDOs could be out of compliance with their over collateralization tests as of one or more measurement dates within the next twelve months. Our ability to rebalance will depend upon the availability of suitable securities, market prices, whether the reinvestment period of the applicable CDO has ended, and other factors that are beyond our control. Such rebalancing efforts may be extremely difficult given current market conditions and we cannot assure you that we will be successful in our rebalancing efforts. If the liabilities of our CDOs are downgraded by Moody's to certain predetermined levels, our discretion to rebalance the applicable CDO portfolios may be negatively impacted. Moreover, if we bring these coverage tests into compliance, we cannot assure you that they will not fall out of compliance in the future or that we will be able to correct any noncompliance. For a more detailed discussion of the impact of CDO financings on our cash flows, see Part I, Item 1A, "Risk Factors – Risks Relating to our Business – The coverage tests applicable to our CDO financings may have a negative impact on our operating results and cash flows".
- (6) Represents excess or deficiency under the applicable over collateralization or interest coverage tests to the first threshold at which cash flow would be redirected. We generally do not receive material cash flow from the junior classes of a CDO until a deficiency is corrected. Ratings downgrades of assets in our CDOs can negatively impact compliance with the over collateralization tests. Generally, the over collateralization test measures the principal balance of the specified pool of assets in a CDO against the corresponding liabilities issued by the CDO. However, based on ratings downgrades, the principal balance of an asset or of a specified percentage of assets in a CDO may be deemed reduced below their current balance to levels set forth in the related CDO documents for purposes of calculating the over collateralization test. As a result, ratings downgrades can reduce the principal balance of the assets used in the over collateralization test relative to the corresponding liabilities in the test, thereby reducing the over collateralization percentage. In addition, actual defaults of an asset would also negatively impact compliance with the over collateralization tests. Failure to satisfy an over collateralization test could result in the redirection of cashflows as described in footnote 5 above or, in certain circumstances, in our removal as manager of the applicable portfolio.
- (7) Our CDO financings typically have a 5 year reinvestment period. Generally, after such period ends, principal payments on the collateral are used to paydown the most senior debt outstanding. Prior to the end of the reinvestment period, principal payments received on the collateral are reinvested.
- (8) At the option call date, Newcastle, as the equity holder, has the right to payoff the CDO bonds at their related redemption price.
- (9) At the auction call date, there is a mandatory auction of the assets pursuant to which the collateral manager will solicit bids for the CDO assets. If the aggregate amount of bids is sufficient to pay off the outstanding CDO bonds set forth in the CDO governing document, the assets will be sold and the CDO bonds will be redeemed. However, if the aggregate amount of the bids is insufficient to pay off the outstanding CDO bonds set forth in the CDO governing document, the assets will not be sold and the redemption of CDO bonds will not occur.
- (10) Debt spread represents the spread above the benchmark interest rate (LIBOR or U.S. Treasuries) that Newcastle pays on its debt.

The following table sets forth further information with respect to the bonds of our consolidated CDO financings as of December 31, 2011 (dollars in thousands):

Class	Original Face Amount	Current Face Amount (1)			Total	Stated Interest Rate
		Held By				
		Third Parties	Newcastle CDOs (2)	Newcastle Outside of its CDOs (3)		
<b>CDO IV</b>						
Class I	\$ 353,250	\$ 78,967	\$ -	\$ 60,508	\$ 139,475	LIBOR + 0.40%
Class II-FL	13,000	3,000	-	10,000	13,000	LIBOR + 0.65%
Class II-FX	7,250	-	5,250	2,000	7,250	4.73%
Class III-FL	7,500	5,000	-	2,500	7,500	LIBOR + 1.00%
Class III-FX	15,000	1,462	-	10,623	12,085	5.11%
Class IV-FL	9,000	8,325	-	-	8,325	LIBOR + 2.25%
Class IV-FX	9,000	9,891	-	-	9,891	6.34%
Class V	13,500	-	-	16,731	16,731	8.67%
Preferred	22,500	-	-	22,500	22,500	N/A
	<u>\$ 450,000</u>	<u>\$ 106,645</u>	<u>\$ 5,250</u>	<u>\$ 124,862</u>	<u>\$ 236,757</u>	
<b>CDO VI</b>						
Class I-MM LT	\$ 323,000	\$ -	\$ 29,591	\$ 130,636 *	\$ 160,227	LIBOR + 0.25%
Class I-B	59,000	59,000	-	-	59,000	LIBOR + 0.40%
Class II	33,000	23,461	-	10,200	33,661	LIBOR + 0.50%
Class III-FL	15,000	5,157	-	10,314	15,471	LIBOR + 0.80%
Class III-FX	5,000	-	-	5,869	5,869	5.67%
Class IV-FL	9,600	635	-	9,526	10,161	LIBOR + 1.70%
Class IV-FX	2,400	2,888	-	-	2,888	6.55%
Class V	21,000	-	-	26,183	26,183	7.81%
Preferred	32,000	-	-	32,000	32,000	N/A
	<u>\$ 500,000</u>	<u>\$ 91,141</u>	<u>\$ 29,591</u>	<u>\$ 224,728</u>	<u>\$ 345,460</u>	
* Of the \$130.6 million CDO VI Class I-MM bonds, \$101.5 million served as collateral for a \$64.3 million bank loan owned jointly by two of Newcastle's CDOs and \$29.1 million served as collateral for a \$8.7 million repurchase agreement financing.						
<b>CDO VIII</b>						
Class I-A	\$ 462,500	\$ 441,856	\$ -	\$ 16,518	\$ 458,374	LIBOR + 0.28%
Class I-AR	60,000	59,464	-	-	59,464	LIBOR + 0.34%
Class I-B	38,000	4,000	-	34,000	38,000	LIBOR + 0.36%
Class II	42,750	-	29,000	13,750	42,750	LIBOR + 0.42%
Class III	42,750	-	22,750	20,000	42,750	LIBOR + 0.50%
Class IV	28,500	-	-	-	-	LIBOR + 0.60%
Class V	28,500	28,500	-	-	28,500	LIBOR + 0.75%
Class VI	27,312	-	-	-	-	LIBOR + 0.80%
Class VII	21,375	-	-	-	-	LIBOR + 0.90%
Class VIII	22,563	11,063	8,250	3,250	22,563	LIBOR + 1.45%
Class IX-FL	6,000	6,000	-	-	6,000	LIBOR + 1.80%
Class IX-FX	7,600	7,600	-	-	7,600	6.80%
Class X	19,650	18,650	-	-	18,650	LIBOR + 2.25%
Class XI	26,125	-	-	24,125	24,125	LIBOR + 2.50%
Class XII	28,500	-	11,500	17,000	28,500	7.50%
Preferred	87,875	-	-	87,875	87,875	N/A
	<u>\$ 950,000</u>	<u>\$ 577,133</u>	<u>\$ 71,500</u>	<u>\$ 216,518</u>	<u>\$ 865,151</u>	

Class	Original Face Amount	Current Face Amount (1)				Total	Stated Interest Rate
		Held By					
		Third Parties	Newcastle CDOs (2)	Newcastle Outside of its CDOs (3)			
<b>CDO IX (4)</b>							
Class A-1	\$ 379,500	\$ 379,500	\$ -	\$ -	\$ 379,500	LIBOR + 0.26%	
Class A-2	115,500	65,500	-	50,000	115,500	LIBOR + 0.47%	
Class B	37,125	35,125	-	2,000	37,125	LIBOR + 0.65%	
Class C	33,000	-	-	-	-	LIBOR + 0.93%	
Class D	20,625	-	-	-	-	LIBOR + 1.00%	
Class E	24,750	-	-	24,750	24,750	LIBOR + 1.10%	
Class F	18,562	-	-	18,562	18,562	LIBOR + 1.30%	
Class G	18,562	-	-	11,262	11,262	LIBOR + 1.50%	
Class H	21,656	-	8,751	9,305	18,056	LIBOR + 2.50%	
Class J	21,656	-	21,656	-	21,656	LIBOR + 3.00%	
Class K	19,593	-	19,593	-	19,593	LIBOR + 3.50%	
Class L	23,718	-	-	23,718	23,718	7.50%	
Class M	39,187	-	-	39,187	39,187	8.00%	
Preferred	51,566	-	-	51,566	51,566	N/A	
	<u>\$ 825,000</u>	<u>\$ 480,125</u>	<u>\$ 50,000</u>	<u>\$ 230,350</u>	<u>\$ 760,475</u>		
<b>CDO X (4)</b>							
Class A-1	\$ 980,000	\$ 980,000	\$ -	\$ -	\$ 980,000	LIBOR + 0.26%	
Class A-2	140,000	140,000	-	-	140,000	LIBOR + 0.35%	
Class A-3	99,750	30,000	-	-	30,000	LIBOR + 0.60%	
Class B	28,000	-	-	-	-	LIBOR + 1.25%	
Class C	40,250	-	32,250	-	32,250	LIBOR + 1.75%	
Class D	22,000	-	22,000	-	22,000	LIBOR + 2.50%	
Class E	13,500	-	-	13,500	13,500	LIBOR + 3.00%	
Class F	14,000	-	-	14,000	14,000	9.04%	
Preferred	62,500	-	-	62,500	62,500	N/A	
	<u>\$ 1,400,000</u>	<u>\$ 1,150,000</u>	<u>\$ 54,250</u>	<u>\$ 90,000</u>	<u>\$ 1,294,250</u>		

- (1) The amounts presented in these columns exclude the face amount of any cancelled bonds within an applicable class.
- (2) Amounts in this column represent the amount of bonds of the applicable class held by Newcastle's consolidated CDOs. These bonds are eliminated in Newcastle's consolidated balance sheet.
- (3) Amounts in this column represent the amount of bonds of the applicable class held as investments by Newcastle outside of its non-recourse financing structures. These bonds are eliminated in Newcastle's consolidated balance sheet.
- (4) These CDOs issued the following interest only fixed-rate notes with a 5-year maturity from inception:
- CDO IX Class S with a notional amount of \$33.5 million at 5.45%
  - CDO X Class S with a notional amount of \$24.2 million at 5.78%

### Stockholders' Equity

#### Common Stock

The following table presents information on shares of our common stock issued since our formation.

Year	Shares Issued	Range of Issue	Net Proceeds
		Prices (1)	(millions)
Formation - 2006	45,713,817		
2007	7,065,362	\$27.75-\$31.30	\$201.3
2008	9,871	N/A	\$0.1
2009	123,463	N/A	\$0.1
2010	9,114,671	\$3.13	\$28.5
2011	43,153,825	\$4.55 - \$6.00	\$210.8
December 31, 2011	<u>105,181,009</u>		

- (1) Excludes prices of shares issued pursuant to the exercise of options and of shares issued to our independent directors. Includes prices of shares issued in exchange for preferred stock.

Through December 31, 2011, Fortress had assigned, for no value, options to purchase approximately 1.2 million shares of our common stock to certain of Fortress's employees, of which approximately 0.4 million had been exercised. In addition, Fortress had exercised 0.7 million of its options.

As of December 31, 2011, our outstanding options issued prior to 2011 had a weighted average strike price of \$26.64 and our outstanding options issued in 2011 had a weighted average strike price of \$5.13. Our options outstanding were summarized as follows:

	December 31,	
	2011	2010
Held by the Manager	5,998,947	1,686,447
Issued to the Manager and subsequently transferred to certain of Fortress's employees	798,162	798,162
Issued to the independent directors	16,000	14,000
Total	<u>6,813,109</u>	<u>2,498,609</u>

In March 2011, we issued 17,250,000 shares of our common stock in a public offering at a price to the public of \$6.00 per share for net proceeds of approximately \$98.4 million. For the purpose of compensating the manager for its successful efforts in raising capital for us, in connection with this offering, we granted options to the manager to purchase 1,725,000 shares of our common stock at the public offering price, which were valued at approximately \$7.0 million.

In September 2011, we issued 25,875,000 shares of our common stock in a public offering at a price to the public of \$4.55 per share for net proceeds of approximately \$112.3 million. Certain principals of Fortress and certain of our officers participated in this offering and purchased an aggregate of 1,314,780 shares at the offering price. For the purpose of compensating the manager for its successful efforts in raising capital for us, in connection with this offering, we granted options to the manager to purchase 2,587,500 shares of our common stock at the public offering price, which were valued at approximately \$5.6 million as of the grant date.

As of December 31, 2011, approximately 4.8 million shares of our common stock were held by Fortress, through its affiliates, and its principals.

#### Preferred Stock

In 2003, we issued 2.5 million shares (\$62.5 million face amount), of 9.75% Series B Cumulative Redeemable Preferred Stock (the "Series B Preferred"). In 2005, we issued 1.6 million shares (\$40.0 million face amount) of 8.05% Series C Cumulative Redeemable Preferred Stock (the "Series C Preferred"). In 2007, we issued 2.0 million shares (\$50.0 million face amount) of 8.375% Series D Cumulative Redeemable Preferred Stock (the "Series D Preferred"). The Series B Preferred, Series C Preferred and Series D Preferred have a \$25 liquidation preference, no maturity date and no mandatory redemption. We have the option to redeem the Series B Preferred and the Series C Preferred, and, beginning in March 2012, we will have the option to redeem the Series D Preferred, at their liquidation preference. If the Series C Preferred and Series D Preferred cease to be listed on the NYSE or the AMEX, or quoted on the NASDAQ, and we are not subject to the reporting requirements of the Exchange Act, we have the option to redeem the Series C Preferred or Series D Preferred, as applicable, at their liquidation preference and, during such time any shares of Series C Preferred or Series D Preferred are outstanding, the dividend will increase to 9.05% or 9.375% per annum, respectively.

To the extent we have unpaid accrued dividends on our preferred stock, we cannot pay any dividends on our common shares, pay any consideration to repurchase or otherwise acquire stock of our common stock or redeem any stock of any series of our preferred stock without redeeming all of our outstanding preferred stock in accordance with the governing documentation. Moreover, if we do not pay dividends on any series of preferred stock for six or more periods, then holders of each affected series obtain the right to call a special meeting and elect two members to our board of directors. Consequently, if we do not make a dividend payment on our preferred stock for six or more quarterly periods, it could restrict the actions that we may take with respect to our common stock and preferred stock and could affect the composition of our board and, thus, the management of our business. No assurance can be given that we will pay any dividends on any series of our preferred stock in the future.

In March 2010, Newcastle settled its offer to exchange (the "Exchange Offer") shares of its common stock and cash for shares of its preferred stock. In the aggregate, Newcastle issued 9,091,668 shares of its common stock (approximately 17.2% of Newcastle's outstanding shares of common stock prior to the issuance of shares in the Exchange Offer). A total of 2,881,694 shares of common stock were issued in exchange for 1,152,679 shares of Series B Preferred, a total of 2,759,989 shares of common stock were issued in exchange for 1,104,000 shares of Series C Preferred, and a total of 3,449,985 shares of common stock were issued in exchange for 1,380,000 shares of Series D Preferred. The shares of preferred stock

acquired by Newcastle in the Exchange Offer were retired upon receipt. After settlement of the Exchange Offer, 1,347,321 shares of Series B Preferred, 496,000 shares of Series C Preferred and 620,000 shares of Series D Preferred remain outstanding for trading on the New York Stock Exchange.

The shares of common stock were issued in the Exchange Offer in reliance on the exemption set forth in Section 3(a)(9) of the Securities Act of 1933, as amended, for securities exchanged by an issuer with its existing security holders exclusively where no commission or other remuneration is paid or given directly or indirectly for soliciting such exchange.

The \$43.0 million excess of the \$87.5 million carrying value of the exchanged preferred stock over the \$44.5 million fair value of consideration paid (which included \$28.5 million of common stock and \$16.0 million of cash) was recorded as an increase to Net Income (Loss) Applicable to Common Stockholders.

All accrued dividends on our preferred stock have been paid through January 31, 2012.

#### Accumulated Other Comprehensive Income (Loss)

During the year ended December 31, 2011, our accumulated other comprehensive income (loss) changed due to the following factors (in thousands):

	Gains/ Losses on Cash Flow Hedges	Gains / Losses on Securities	Total Accumulated Other Comprehensive Income (Loss)
Accumulated other comprehensive income (loss), December 31, 2010	\$ (116,908)	\$ 70,730	\$ (46,178)
Deconsolidation of unrealized gain on securities in CDO V	-	(8,026)	(8,026)
Deconsolidation of unrealized loss on derivatives designated as cash flow hedges in CDO V	18,353	-	18,353
Net unrealized gain (loss) on securities	-	(4,786)	(4,786)
Reclassification of net realized (gain) loss on securities into earnings	-	(60,503)	(60,503)
Net unrealized gain (loss) on derivatives designated as cash flow hedges	15,514	-	15,514
Reclassification of net realized (gain) loss on derivatives designated as cash flow hedges into earnings	12,540	-	12,540
Accumulated other comprehensive income (loss), December 31, 2011	\$ (70,501)	\$ (2,585)	\$ (73,086)

Our GAAP equity changes as our real estate securities portfolio and derivatives are marked to market each quarter, among other factors. The primary causes of mark to market changes are changes in interest rates and credit spreads. During the year ended December 31, 2011, a net widening of credit spreads has caused the net unrealized gains recorded in accumulated other comprehensive income on our real estate securities to turn into unrealized losses. Net unrealized losses on derivatives designated as cash flow hedges decreased for the year, primarily as a result of (i) the de-designation of certain cash flow hedges, (ii) the deconsolidation of CDO V and (iii) increases in long-term interest rates.

See “– Market Considerations” above for a further discussion of recent trends and events affecting our unrealized gains and losses as well as our liquidity.

#### Common Dividends Paid

Declared for the Period Ended	Paid	Amount Per Share
December 31, 2009 (Year)	N/A	\$0.00
December 31, 2010 (Year)	N/A	\$0.00
June 30, 2011	July 2011	\$0.10
September 30, 2011	October 2011	\$0.15
December 31, 2011	January 2012	\$0.15

#### Cash Flow

#### Operating Activities

Net cash flow provided by operating activities increased from \$48.9 million for the year ended December 31, 2010 to \$57.0 million for the year ended December 31, 2011. It decreased from \$74.2 million for the year ended December 31, 2009 to \$48.9 million for the year ended December 31, 2010. These changes are attributable to the factors described below:

## 2011 compared to 2010

- Interest received on securities and loans decreased approximately \$30.6 million as a result of a lower average balance of interest earning securities and loans of \$3.7 billion in 2011 compared to \$4.4 billion in 2010. The lower interest earning asset balance is primarily a result of paydowns, sales and deconsolidation of CDO V. This was offset by an increase in the weighted average interest rate to 5.25% in 2011 from 5.03% in 2010.
- Furthermore, as a result of the reduction of defaulted assets through sales or restructuring, improvements in the results of certain CDO over collateralization tests and the deconsolidation of CDO V, the net interest income redirected for reinvestment or CDO bond paydown decreased by approximately \$15.7 million in 2010, resulting in an increase in recorded interest income.
- An increase of \$0.9 million in deferred interest received for the year ended December 31, 2011 compared to the year ended December 31, 2010 as a result of a CDO passing certain over-collateralization tests.
- C-BASS collateral management fees, loan restructuring fees and excess mortgage servicing fees of approximately \$3.8 million received in the year ended December 31, 2011. This investment was made in February 2011.
- A decrease in prepayment penalty income of \$7.2 million for the year ended December 31, 2011 compared to the year ended December 31, 2010.
- Interest paid on debt obligations decreased approximately \$26.5 million as a result of (i) a lower average debt balance of \$3.1 billion in 2011 compared to \$3.8 billion in 2010, primarily due to the deconsolidation of CDO V and the repurchase of CDO VI Class I-MM notes, (ii) a net decrease in interest payments on our interest rate swaps which experienced a decrease in their average aggregate notional balance from \$1.9 billion in 2010 to \$1.5 billion in 2011. The decreases in (i) and (ii) above were partially offset by an increase in the weighted average coupon to 1.06% for the year ended December 31, 2011 from 0.94% for the year ended December 31, 2010 and an increase in the weighted average effective pay rate on our interest rate swaps from 4.78% in 2010 to 4.83% in 2011.
- Management fees paid increased approximately \$1.0 million in 2011 compared to 2010 due to an increase in gross equity as a result of our public offerings of common stock in March 2011 and September 2011, partially offset by the return of capital distributions made on our preferred stock in 2010.

## 2010 compared to 2009

- Cash interest received for investments in securities and loans decreased approximately \$58.2 million as a result of a lower average balance of interest bearing securities and loans of \$4.4 billion in 2010 compared to \$5.5 billion in 2009, which is offset by an increase in the weighted average coupon to 5.03% in 2010 from 4.96% in 2009. The lower interest earning asset balance is primarily a result of paydowns, sales and delinquencies.
- Furthermore, as a result of increases in defaulted assets and CDOs failing certain coverage tests, the net interest income redirected for reinvestment or CDO bond paydown increased by approximately \$4.9 million in 2010.
- Prepayment penalty income decreased by approximately \$1.0 million in 2010 due to a lower volume of prepayments in 2010 compared to 2009.
- Cash interest paid decreased approximately \$35.7 million due to (i) a lower average debt balance of \$3.8 billion in 2010 compared to \$4.8 billion in 2009 and a decrease in the weighted average coupon to 0.94% in 2010 from 1.04% in 2009 and (ii) a net decrease in interest payments on our interest rate swaps which experienced a decrease in their average notional balance to \$1.9 billion in 2010 from \$2.4 billion in 2009, offset by an increase in the weighted average effective pay rate from 4.60% in 2009 to 4.78% in 2010.
- General and administrative expenses paid in 2010 decreased approximately \$1.2 million primarily due to lower insurance expense in 2010 compared to 2009.

### Investing Activities

Investing activities provided (used) (\$226.1) million, \$76.4 million and \$172.1 million during the years ended December 31, 2011, 2010 and 2009, respectively. Investing activities consisted primarily of the investments made in real estate securities, excess MSR investments, and loans outside of our CDO financing structures, net of proceeds from the sale or settlement of investments.

### Financing Activities

Financing activities provided (used) \$292.9 million, (\$160.1) million and (\$227.7) million during the years ended December 31, 2011, 2010 and 2009, respectively. The public offerings of common stock, return of restricted cash from refinancing activities, refinancing of our manufactured housing loan portfolio and borrowings under repurchase agreements served as the primary sources of cash flow from financing activities. Offsetting uses included the repayment of debt as described above, the payment of related deferred financing costs, the payment of common and preferred dividends, and the payment related to the exchange of the junior subordinated notes, as well as the payment related to the preferred stock exchange described under “– Preferred Stock” above.

See the consolidated statements of cash flows in our consolidated financial statements included in “Financial Statements and Supplementary Data” for a reconciliation of our cash position for the periods described herein.

### **Interest Rate, Credit and Spread Risk**

We are subject to interest rate, credit and spread risk with respect to our investments. These risks are further described in Part II, Item 7A, “Quantitative and Qualitative Disclosures About Market Risk.”

### **Off-Balance Sheet Arrangements**

As of December 31, 2011, we had the following material off-balance sheet arrangements. We believe that these off-balance sheet structures presented the most efficient and least expensive form of financing for these assets at the time they were entered, and represented the most common market-accepted method for financing such assets.

- In April 2006, we securitized Subprime Portfolio I. The loans were sold to a securitization trust, of which 80% were treated as a sale, which is an off-balance sheet financing.
- In July 2007, we securitized Subprime Portfolio II. The loans were sold to a securitization trust, of which 90% were treated as a sale, which is an off-balance sheet financing.
- On June 17, 2011, we deconsolidated CDO V, which is now effectively an off-balance sheet financing.

We have no obligation to repurchase any loans from either of our subprime securitizations. Therefore, it is expected that our exposure to loss is limited to the carrying amount of our retained interests in the securitization entities, as described above. A subsidiary of ours gave limited representations and warranties with respect to the second securitization; however, it has no assets and does not have recourse to the general credit of Newcastle.

We also had the following arrangements which do not meet the definition of off-balance sheet arrangements, but do have some of the characteristics of off-balance sheet arrangements.

- We have made investments in three equity method investees, two of which are dormant at December 31, 2011 and the other of which is immaterial to our financial condition, liquidity, and operations.

In each case, our exposure to loss is limited to the carrying (fair) value of our investment.

### **Contractual Obligations**

As of December 31, 2011, we had the following material contractual obligations (payments in thousands):

<u>Contract</u>	<u>Terms</u>
CDO bonds payable	Described under Part II, Item 7A, “Quantitative and Qualitative Disclosures About Market Risk”
Other bonds and notes payable	Described under Part II, Item 7A, “Quantitative and Qualitative Disclosures About Market Risk”
Repurchase agreements	Described under Part II, Item 7A, “Quantitative and Qualitative Disclosures About Market Risk”
Junior subordinated notes payable	Described under Part II, Item 7A, “Quantitative and Qualitative Disclosures About Market Risk”
Derivative liabilities	Described under Part II, Item 7A, “Quantitative and Qualitative Disclosures About Market Risk”

Management agreement	Our manager is paid an annual management fee of 1.5% of our gross equity, as defined, an expense reimbursement, and incentive compensation equal to 25% of our adjusted net income available for common stockholders above a certain threshold. For more information on this agreement, as well as historical amounts earned, see Note 10 to Part II, Item 8, "Financial Statements and Supplementary Data." As a result of not meeting the incentive compensation threshold, the incentive compensation to the Manager has been discontinued for an indeterminate period of time.
Subprime loan securitization and CDO V	We entered into the securitization of Subprime Portfolios I and II, and also entered into CDO V, which was subsequently deconsolidated, as described under "– Liquidity and Capital Resources."
Loan servicing agreements	We are a party to servicing agreements with respect to our residential mortgage loans, including manufactured housing loans and subprime mortgage loans. We pay annual servicing fees generally equal to 0.375% of the outstanding face amount of the residential mortgage loans, and 1.00% of the outstanding face amount of each of the two portfolios of manufactured housing loans. We also pay an incentive fee for one of the portfolios of manufactured housing loans if the performance of the loans meets certain thresholds.
Trustee agreements	We have entered into trustee agreements in connection with our securitized investments, primarily our CDOs. We pay annual fees of between 0.015% and 0.020% of the outstanding face amount of the CDO bonds under these agreements.

<u>Contract</u>	Fixed and Determinable Payments Due by Period				
	<u>2012</u>	<u>2013-2014</u>	<u>2015-2016</u>	<u>Thereafter</u>	<u>Total</u>
CDO bonds payable (1)	\$ 18,212	\$ 33,571	\$ 33,571	\$ 2,968,494	\$ 3,053,848
Other bonds and notes payable (1)	8,724	17,448	17,448	356,127	399,747
Repurchase agreements (2)	239,740	-	-	-	239,740
Financing of subprime mortgage loans subject to future repurchase (3)	N/A	N/A	N/A	N/A	N/A
Junior subordinated notes payable (1)	3,863	7,726	6,616	93,498	111,703
Interest rate swaps, treated as hedges (4)	-	1,849	50,506	37,670	90,025
Non-hedge derivative obligations (5)	29,295	-	-	-	29,295
Management agreement (6)	19,404	38,808	38,808	485,104	582,124
Subprime loan securitizations	*	*	*	*	*
CDO V	*	*	*	*	*
Loan servicing agreements	*	*	*	*	*
Trustee agreements	*	*	*	*	*
<b>Total</b>	<b>\$ 319,238</b>	<b>\$ 99,402</b>	<b>\$ 146,949</b>	<b>\$ 3,940,893</b>	<b>\$ 4,506,482</b>

\* These contracts do not have fixed and determinable payments.

- (1) Includes interest based on rates existing at December 31, 2011 and assuming no prepayments. Obligations that are repayable prior to maturity at the option of Newcastle are reflected at their contractual maturity dates.
- (2) Repurchase agreements, which have not been term financed, and mature within one year of our financial statement date, are included in this table assuming no interest.
- (3) These obligations represent the related financing on the loans which are subject to future repurchase by Newcastle and are offset by the amount of such loans. See Note 5 to Part II, Item 8, "Financial Statements and Supplementary Data".
- (4) These agreements are held within our non-recourse financing structures. The amounts reflected assume that these agreements are terminated at their December 31, 2011 fair value and paid at the contractual maturity of the related interest rate swap agreements.
- (5) The amounts reflected assume that these agreements are terminated at their December 31, 2011 fair value on January 1, 2012.
- (6) Amounts reflect base management fees for the next 30 years assuming no change in gross equity, as defined, from December 31, 2011.

## **Inflation**

Virtually all of our assets and liabilities are financial in nature. As a result, interest rates and other factors affect our performance more so than inflation, although inflation rates can often have a meaningful influence over the direction of interest rates. Furthermore, our financial statements are prepared in accordance with GAAP and our distributions are determined by our board of directors primarily based on our taxable income, and, in each case, our activities and balance sheet are measured with reference to historical cost and/or fair market value without considering inflation. See Part II, Item 7A, "Quantitative and Qualitative Disclosure About Market Risk — Interest Rate Exposure" below.

## Core Earnings

Newcastle has five primary variables that impact its operating performance: (i) the current yield earned on its investments that are not included in non-recourse financing structures (i.e., unlevered investments and investments subject to recourse debt), (ii) the net yield it earns from its non-recourse financing structures, (iii) the interest expense and dividends incurred under its recourse debt and preferred stock, (iv) its operating expenses, and (v) its realized and unrealized gains on its investments, derivatives and debt obligations, including impairment. “Core earnings,” which was referred to as “Net Interest Income Less Expenses (Net of Preferred Dividends)” in our prior filings, is a non-GAAP measure of the operating performance of Newcastle that excludes the fifth variable listed above and is equal to net interest income less expenses and preferred dividends. It is used by management to gauge the current performance of Newcastle without taking into account gains and losses, which, although they represent a part of our recurring operations, are subject to significant variability and are only a potential indicator of future economic performance. Management views this measure as Newcastle’s “core” current earnings, while gains and losses (including impairment) are simply a potential indicator of future earnings. Management believes that this measure provides investors with useful information regarding Newcastle’s “core” current earnings, and it enables investors to evaluate Newcastle’s current performance using the same measure that management uses to operate the business.

Core earnings does not represent cash generated from operating activities in accordance with GAAP and therefore should not be considered an alternative to net income as an indicator of our operating performance or as an alternative to cash flow as a measure of our liquidity and is not necessarily indicative of cash available to fund cash needs. For a further description of the differences between cash flow provided by operations and net income, see “–Liquidity and Capital Resources” above. Our calculation of core earnings may be different from the calculation used by other companies and, therefore, comparability may be limited.

Set forth below is a reconciliation of core earnings to the most directly comparable GAAP financial measure (in thousands).

	Year Ended December 31,		
	2011	2010	2009
Income (loss) applicable to common stockholders	\$ 253,867	\$ 657,252	\$ (223,405)
Add (Deduct):			
Impairment (reversal)	677	(240,858)	548,540
Other (income) loss	(135,790)	(282,287)	(227,399)
(Income) loss from discontinued operations	(306)	8	318
Excess of carrying amount of exchanged preferred stock over fair value of consideration	-	(43,043)	-
Core earnings	<u>\$ 118,448</u>	<u>\$ 91,072</u>	<u>\$ 98,054</u>

## Cash Available For Distributions (“CAD”)

Newcastle determines its common dividends based significantly on cash available for distribution, which is net cash flow from operations plus principal repayments less return of capital and preferred dividends. We believe that CAD is useful for investors because it is a meaningful measure of our operating liquidity. Management uses CAD as an important input in determining Newcastle’s dividends. It represents GAAP net cash provided by operating activities adjusted for essentially two factors:

- (i) Principal payments received from Newcastle’s investments in repurchased CDO debt and CDO securities in excess of the portion which represents a return of Newcastle’s invested capital. Although these net principal repayments are reported as investing activities for GAAP purposes, they actually represent a portion of Newcastle’s return on these investments (or yield), rather than a return of Newcastle’s invested capital.
- (ii) Preferred dividends. Although these dividends are reported as financing activities for GAAP purposes, they represent a recurring use of Newcastle’s operating cash flow similar to interest payments on debt.

CAD is limited in its usefulness because it excludes principal repayments from non-CDO investments (since these principal repayments tend to represent primarily returns of capital and/or are required to be used to directly pay down Newcastle’s debt). Furthermore, net cash provided by operating activities, a primary element of CAD, includes timing differences based on changes in accruals. CAD does not represent cash generated from operating activities in accordance with GAAP and should not be considered an alternative to net income as an indicator of our operating performance or as an alternative to cash flow as a measure of our liquidity and is not necessarily indicative of cash available to fund cash needs. Our calculation of CAD may be different from the calculation used by other companies and therefore comparability may be limited.

Set forth below is a reconciliation of CAD to the most directly comparable GAAP liquidity measure (in thousands).

	Year Ended December 31,		
	2011	2010	2009
Net cash provided by (used in) operating activities	\$ 57,031	\$ 48,890	\$ 74,169
Add (Deduct):			
Principal repayments from repurchased CDO debt	65,912	1,211	-
Principal repayments from CDO securities	10,728	-	-
Return of capital included above <sup>(1)</sup>	(51,148)	(550)	-
Preferred dividends <sup>(2)</sup>	(5,580)	(7,453)	(13,501)
Cash available for distribution	<u>\$ 76,943</u>	<u>\$ 42,098</u>	<u>\$ 60,668</u>

Other data from the consolidated statements of cash flows:

	Year Ended December 31,		
	2011	2010	2009
Net cash provided by (used in) investing activities	\$ (226,135)	\$ 76,443	\$ 172,084
Net cash provided by (used in) financing activities	\$ 292,936	\$ (160,109)	\$ (227,699)
Net increase (decrease) in cash and cash equivalents	\$ 123,832	\$ (34,776)	\$ 18,554

(1) Represents the portion of principal repayments from repurchased CDO debt and from CDO securities computed based on the ratio of Newcastle's purchase price of such debt or securities to the aggregate principal payments expected to be received from such debt or securities.

(2) Represents preferred dividends to be paid on an accrual basis.

## **Item 7A. Quantitative and Qualitative Disclosures About Market Risk.**

Market risk is the exposure to loss resulting from changes in interest rates, credit spreads, foreign currency exchange rates, commodity prices and equity prices. The primary market risks that we are exposed to are interest rate risk and credit spread risk. These risks are highly sensitive to many factors, including governmental monetary and tax policies, domestic and international economic and political considerations and other factors beyond our control. All of our market risk sensitive assets, liabilities and derivative positions are for non-trading purposes only. For a further understanding of how market risk may effect our financial position or operating results, please refer to Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Application of Critical Accounting Policies.”

### **Interest Rate Exposure**

Changes in interest rates, including changes in expected interest rates or “yield curves,” affect our investments in two distinct ways, each of which is discussed below.

First, changes in interest rates affect our net interest income, which is the difference between the interest income earned on assets and the interest expense incurred in connection with our debt obligations and hedges.

One component of our financing strategy includes the use of match funded structures, when appropriate and available. This means that we seek to match the maturities of our debt obligations with the maturities of our assets to reduce the risk that we have to refinance our liabilities prior to the maturities of our assets, and to reduce the impact of changing interest rates on our earnings. In addition, we seek to match fund interest rates on our assets with like-kind debt (i.e., fixed rate assets are financed with fixed rate debt and floating rate assets are financed with floating rate debt), directly or through the use of interest rate swaps, caps or other financial instruments (see below), or through a combination of these strategies, which we believe allows us to reduce the impact of changing interest rates on our earnings.

However, increases in interest rates can nonetheless reduce our net interest income to the extent that we are not completely match funded. Furthermore, a period of rising interest rates can negatively impact our return on certain floating rate investments. Although these investments may be financed with floating rate debt, the interest rate on the debt may reset prior to, and in some cases more frequently than, the interest rate on the assets, causing a decrease in return on equity during a period of rising interest rates.

As of December 31, 2011, a 100 basis point increase in short term interest rates would increase our earnings by approximately \$0.4 million per annum, based on the current net floating rate exposure from our investments, financings and interest rate derivatives.

Second, changes in the level of interest rates also affect the yields required by the marketplace on debt. Increasing interest rates would decrease the value of the fixed rate assets we hold at the time because higher required yields result in lower prices on existing fixed rate assets in order to adjust their yield upward to meet the market.

Changes in unrealized gains or losses resulting from changes in market interest rates do not directly affect our cash flows, or our ability to pay a dividend, as the related assets are expected to be held and their fair value is not directly relevant to their underlying cash flows. Our assets are largely financed to maturity through long term CDO financings that are not redeemable as a result of book value changes. As long as these fixed rate assets continue to perform as expected, our cash flows from these assets would not be affected by increasing interest rates. Changes in unrealized gains or losses would impact our ability to realize gains on existing investments if they were sold. Furthermore, with respect to changes in unrealized gains or losses on investments which are carried at fair value, changes in unrealized gains or losses would impact our net book value and, in the cases of impaired assets and non-hedge derivatives, our net income (loss).

Changes in the value of our assets could affect our ability to borrow and access capital. Also, if the value of our assets subject to short term financing were to decline, it could cause us to fund margin and affect our ability to refinance such assets upon the maturity of the related financings, adversely impacting our rate of return on such securities.

As of December 31, 2011, a 100 basis point change in short term interest rates would impact our net book value by approximately \$11.9 million, based on the current net floating rate exposure from our investments, financings and interest rate derivatives.

Interest rate swaps are agreements in which a series of interest rate flows are exchanged with a third party (counterparty) over a prescribed period. The notional amount on which swaps are based is not exchanged. In general, our swaps are “pay fixed” swaps involving the exchange of floating rate interest payments from the counterparty for fixed interest payments from us. This can effectively convert a floating rate debt obligation into a fixed rate debt obligation. Interest rate swaps may be subject to margin calls.

Similarly, an interest rate cap or floor agreement is a contract in which we purchase a cap or floor contract on a notional face amount. We will make an up-front payment to the counterparty for which the counterparty agrees to make future payments to us should the reference rate (typically LIBOR) rise above (cap agreements) or fall below (floor agreements) the “strike” rate specified in the contract. Payments on an annualized basis will equal the contractual notional face amount multiplied by the difference between the actual reference rate and the contracted strike rate.

While a REIT may utilize these types of derivative instruments to hedge interest rate risk on its liabilities or for other purposes, such derivative instruments could generate income that is not qualified income for purposes of maintaining REIT status. As a consequence, we may only engage in such instruments to hedge such risks within the constraints of maintaining our standing as a REIT. We do not enter into derivative contracts for speculative purposes nor as a hedge against changes in credit risk.

Our hedging transactions using derivative instruments also involve certain additional risks such as counterparty credit risk, the enforceability of hedging contracts and the risk that unanticipated and significant changes in interest rates will cause a significant loss of basis in the contract. There can be no assurance that we will be able to adequately protect against the foregoing risks and will ultimately realize an economic benefit that exceeds the related amounts incurred in connection with engaging in such hedging strategies.

### **Credit Spread Exposure**

Credit spreads measure the yield demanded on loans and securities by the market based on their credit relative to U.S. Treasuries, for fixed rate credit, or LIBOR, for floating rate credit. Our fixed rate loans and securities are valued based on a market credit spread over the rate payable on fixed rate U.S. Treasuries of like maturity. Our floating rate loans and securities are valued based on a market credit spread over LIBOR. Excessive supply of such loans and securities combined with reduced demand will generally cause the market to require a higher yield on such loans and securities, resulting in the use of a higher (or “wider”) spread over the benchmark rate to value them.

Widening credit spreads would result in higher yields being required by the marketplace on loans and securities. This widening would reduce the value of the loans and securities we hold at the time because higher required yields result in lower prices on existing securities in order to adjust their yield upward to meet the market. The effects of such a decrease in values on our financial position, results of operations and liquidity are discussed above under “- Interest Rate Exposure.”

As of December 31, 2011, a 25 basis point movement in credit spreads would impact our net book value by approximately \$19.4 million, assuming a static portfolio of current investments and financings, but would not directly affect our earnings or cash flow.

Our financing strategy is dependent on our ability to place the match funded debt we use to finance our investments at rates that provide a positive net spread. Currently, spreads for such liabilities have widened and demand for such liabilities has become extremely limited, therefore restricting our ability to execute future financings.

In an environment where spreads are tightening, if spreads tighten on the assets we purchase to a greater degree than they tighten on the liabilities we issue, our net spread will be reduced.

### **Credit Risk**

In addition to the above described market risks, Newcastle is subject to credit risk.

Credit risk refers to the ability of each individual borrower under our loans and securities to make required interest and principal payments on the scheduled due dates. The commercial mortgage and asset backed securities we invest in are generally junior in right of payment of interest and principal to one or more senior classes, but benefit from the support of one or more subordinate classes of securities or other form of credit support (which absorbs losses before the securities in which we invest) within a securitization transaction. The senior unsecured REIT debt securities we invest in reflect comparable credit risk. The value of the subordinated securities has generally been reduced or, in some cases, eliminated, which could leave our securities economically in a first loss position. We also invest in loans and securities which represent “first loss” pieces; in other words, they do not benefit from credit support although we believe at acquisition they predominantly benefit from underlying collateral value in excess of their carrying amounts.

We seek to reduce credit risk by actively monitoring our asset portfolio and the underlying credit quality of our holdings and, where appropriate and achievable, repositioning our investments to upgrade their credit quality. In the event of a significant rising interest rate environment and/or economic downturn, loan and collateral defaults may increase and result in credit losses that would adversely affect our liquidity and operating results. As described in “Management’s Discussion and Analysis of Financial Condition and Result of Operations – Market Considerations” and elsewhere in this annual

report, adverse market and credit conditions have resulted in our recording of other-than-temporary impairment in certain securities and loans.

### **Prepayment Speed Exposure**

Prepayment speeds significantly affect the value of excess MSR. Prepayment speed is the measurement of how quickly borrowers pay down the unpaid principal balance of their loans or how quickly loans are otherwise brought current, modified, liquidated or charged off. The price we pay in acquiring MSR investments will be based on, among other things, our projection of the cash flows from the related pool of mortgage loans. Our expectation of prepayment speeds is a significant assumption underlying those cash flow projections. If prepayment speeds are significantly greater than expected, the carrying value of excess MSR could exceed their estimated fair value. If the fair value of excess MSR decreases, we would be required to record a non-cash charge, which would have a negative impact on our financial results. Furthermore, a significant increase in prepayment speeds could materially reduce the ultimate cash flows we receive from excess MSR, and we could ultimately receive substantially less than what we paid for such assets.

We seek to reduce our exposure to prepayment through the structuring of our investments in excess MSR. For example, pursuant to the terms of the excess MSR agreement we entered into in December 2011, in the event that mortgage loans are prepaid in full and Nationstar originates the new mortgage loans, subject to certain limitations, we are entitled to the pro rata share of the excess mortgage servicing fees of such “recaptured” loans.

### **Margin**

We are subject to margin calls on our repurchase agreements. Furthermore, we may, from time to time, be a party to derivative agreements or financing arrangements that are subject to margin calls based on the value of such instruments. We seek to maintain adequate cash reserves and other sources of available liquidity to meet any margin calls resulting from decreases in value related to a reasonably possible (in the opinion of management) change in interest rates.

### **Interest Rate and Credit Spread Risk Sensitive Instruments and Fair Value**

Our holdings of such financial instruments, and their fair values and the estimation methodology thereof, are detailed in Note 7 to Part II, Item 8, “Financial Statements and Supplementary Data.” For information regarding the impact of prepayment, reinvestment, and expected loss factors on the timing of realization of our investments, please refer to the consolidated financial statements included therein. For information regarding the impact of changes in these factors on the value of securities valued with internal models, see Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Application of Critical Accounting Policies.”

We note that the values of our investments in real estate securities, loans and derivative instruments are sensitive to changes in market interest rates, credit spreads and other market factors. The value of these investments can vary, and has varied, materially from period to period.

### **Trends**

See “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Market Considerations” for a further discussion of recent trends and events affecting our liquidity, unrealized gains and losses.

**Item 8. Financial Statements and Supplementary Data.**

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Report of Independent Registered Public Accounting Firm

Report on Internal Control Over Financial Reporting of Independent Registered Public Accounting Firm

Consolidated Balance Sheets as of December 31, 2011 and December 31, 2010

Consolidated Statements of Operations for the years ended December 31, 2011, 2010 and 2009

Consolidated Statements of Comprehensive Income for the years ended December 31, 2011, 2010 and 2009

Consolidated Statements of Stockholders' Equity (Deficit) for the years ended December 31, 2011, 2010 and 2009

Consolidated Statements of Cash Flows for the years ended December 31, 2011, 2010 and 2009

Notes to Consolidated Financial Statements

All schedules have been omitted because either the required information is included in our consolidated financial statements and notes thereto or it is not applicable.

## **Report of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholders of Newcastle Investment Corp.

We have audited the accompanying consolidated balance sheets of Newcastle Investment Corp. and Subsidiaries (the "Company") as of December 31, 2011 and 2010, and the related consolidated statements of operations, comprehensive income, stockholders' equity (deficit), and cash flows for each of the three years in the period ended December 31, 2011. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Newcastle Investment Corp. and Subsidiaries at December 31, 2011 and 2010, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2011, in conformity with U.S. generally accepted accounting principles.

As discussed in Notes 2 and 3 to the consolidated financial statements, the Company changed its method of accounting for variable interest entities with the adoption of guidance originally issued in FASB Statement No. 167 (communicated through ASU 2009-17) effective January 1, 2010.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Newcastle Investment Corp. and Subsidiaries' internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 15, 2012 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

New York, New York  
March 15, 2012

## Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders of Newcastle Investment Corp. and Subsidiaries

We have audited Newcastle Investment Corp. and Subsidiaries' internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Newcastle Investment Corp. and Subsidiaries' management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Newcastle Investment Corp. and Subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Newcastle Investment Corp. and Subsidiaries as of December 31, 2011 and 2010, and the related consolidated statements of operations, comprehensive income, stockholders' equity (deficit), and cash flows for each of the three years in the period ended December 31, 2011 of Newcastle Investment Corp. and Subsidiaries and our report dated March 15, 2012 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

New York, New York  
March 15, 2012

NEWCASTLE INVESTMENT CORP. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(dollars in thousands, except share data)

	December 31,	
	2011	2010
<b>Assets</b>		
<u>Non-Recourse VIE Financing Structures</u>		
Real estate securities, available-for-sale - Note 4	\$ 1,479,214	\$ 1,859,984
Real estate related loans, held-for-sale, net - Note 5	807,214	750,130
Residential mortgage loans, held-for-investment, net - Note 5	331,236	124,974
Residential mortgage loans, held-for-sale, net - Note 5	-	252,915
Subprime mortgage loans subject to call option - Note 5	404,723	403,793
Operating real estate, held-for-sale - Note 6	7,741	8,776
Other investments	18,883	18,883
Restricted cash	105,040	157,005
Derivative assets - Note 7	1,954	7,067
Receivables and other assets	23,319	29,206
	<u>3,179,324</u>	<u>3,612,733</u>
<u>Recourse Financing Structures and Unlevered Assets</u>		
Real estate securities, available-for-sale - Note 4	252,530	600
Real estate related loans, held-for-sale, net - Note 5	6,366	32,475
Residential mortgage loans, held-for-sale, net - Note 5	2,687	298
Investments in excess mortgage servicing rights at fair value - Note 5	43,971	-
Other investments	6,024	6,024
Cash and cash equivalents	157,356	33,524
Receivables and other assets	3,541	1,457
	<u>472,475</u>	<u>74,378</u>
	<u>\$ 3,651,799</u>	<u>\$ 3,687,111</u>
<b>Liabilities and Stockholders' Equity (Deficit)</b>		
<b>Liabilities</b>		
<u>Non-Recourse VIE Financing Structures</u>		
CDO bonds payable - Note 8	\$ 2,403,605	\$ 3,010,868
Other bonds and notes payable - Note 8	200,377	261,165
Repurchase agreements - Note 8	6,546	14,049
Financing of subprime mortgage loans subject to call option - Note 5	404,723	403,793
Derivative liabilities - Note 7	119,320	176,861
Accrued expenses and other liabilities	16,112	8,445
	<u>3,150,683</u>	<u>3,875,181</u>
<u>Recourse Financing Structures and Other Liabilities</u>		
Repurchase agreements - Note 8	233,194	4,683
Junior subordinated notes payable - Note 8	51,248	51,253
Dividends Payable	16,707	-
Due to affiliates	1,659	1,419
Accrued expenses and other liabilities	6,219	2,160
	<u>309,027</u>	<u>59,515</u>
	<u>3,459,710</u>	<u>3,934,696</u>
Commitments and contingencies - Notes 9, 10 and 11		
<b>Stockholders' Equity (Deficit)</b>		
Preferred stock, \$0.01 par value, 100,000,000 shares authorized, 1,347,321 shares of 9.75% Series B Cumulative Redeemable Preferred Stock, 496,000 shares of 8.05% Series C Cumulative Redeemable Preferred Stock, and 620,000 shares of 8.375% Series D Cumulative Redeemable Preferred Stock, liquidation preference \$25.00 per share, issued and outstanding as of December 31, 2011 and 2010	61,583	61,583
Common stock, \$0.01 par value, 500,000,000 shares authorized, 105,181,009 and 62,027,184 shares issued and outstanding at December 31, 2011 and 2010, respectively	1,052	620
Additional paid-in capital	1,275,792	1,065,377
Accumulated deficit - Note 2	(1,073,252)	(1,328,987)
Accumulated other comprehensive income (loss) - Note 2	(73,086)	(46,178)
	<u>192,089</u>	<u>(247,585)</u>
	<u>\$ 3,651,799</u>	<u>\$ 3,687,111</u>

See notes to consolidated financial statements.

NEWCASTLE INVESTMENT CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE YEARS ENDED DECEMBER 31, 2011, 2010 and 2009

(dollars in thousands, except share data)

	Year Ended December 31,		
	2011	2010	2009
Interest income	\$ 292,296	\$ 300,272	\$ 361,866
Interest expense	138,035	172,219	218,410
Net interest income	154,261	128,053	143,456
<b>Impairment (Reversal)</b>			
Valuation allowance (reversal) on loans - Note 5	(15,163)	(339,887)	15,007
Other-than-temporary impairment on securities- Note 4	12,955	101,398	603,768
Portion of other-than-temporary impairment on securities recognized in other comprehensive income (loss), net of the reversal of other comprehensive loss into net income (loss)	2,885	(2,369)	(70,235)
	677	(240,858)	548,540
Net interest income (loss) after impairment/reversal	153,584	368,911	(405,084)
<b>Other Income (Loss)</b>			
Gain (loss) on settlement of investments, net - Note 2	78,181	52,307	11,438
Gain on extinguishment of debt - Note 8	66,110	265,656	215,279
Other income (loss), net - Note 2	(8,501)	(35,676)	682
	135,790	282,287	227,399
<b>Expenses</b>			
Loan and security servicing expense	4,649	4,580	5,034
General and administrative expense	7,295	7,696	8,899
Management fee to affiliate - Note 10	18,289	17,252	17,968
	30,233	29,528	31,901
Income (loss) from continuing operations	259,141	621,670	(209,586)
Income (loss) from discontinued operations - Note 6	306	(8)	(318)
<b>Net Income (Loss)</b>	259,447	621,662	(209,904)
Preferred dividends	(5,580)	(7,453)	(13,501)
Excess of carrying amount of exchanged preferred stock over fair value of consideration paid	-	43,043	-
<b>Income (Loss) Applicable To Common Stockholders</b>	\$ 253,867	\$ 657,252	\$ (223,405)
<b>Income (Loss) Per Share of Common Stock</b>			
Basic	\$ 3.09	\$ 10.96	\$ (4.23)
Diluted	\$ 3.09	\$ 10.96	\$ (4.23)
<b>Income (loss) from continuing operations per share of common stock, after preferred dividends and excess of carrying amount of exchanged preferred stock over fair value of consideration paid</b>			
Basic	\$ 3.09	\$ 10.96	\$ (4.22)
Diluted	\$ 3.09	\$ 10.96	\$ (4.22)
<b>Income (loss) from discontinued operations per share of common stock</b>			
Basic	\$ -	\$ -	\$ (0.01)
Diluted	\$ -	\$ -	\$ (0.01)
<b>Weighted Average Number of Shares of Common Stock Outstanding</b>			
Basic	81,983,973	59,948,827	52,863,993
Diluted	81,990,297	59,948,827	52,863,993
<b>Dividends Declared per Share of Common Stock</b>	\$ 0.40	\$ -	\$ -

**NEWCASTLE INVESTMENT CORP. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

FOR THE YEARS ENDED DECEMBER 31, 2011, 2010 and 2009

(dollars in thousands)

	Years Ended December 31,		
	2011	2010	2009
Net income	\$ 259,447	\$ 621,662	\$ (209,904)
Other comprehensive income (loss):			
Net unrealized gain (loss) on securities	(4,786)	439,496	306,626
Reclassification of net realized (gain) loss on securities into earnings	(60,503)	43,442	522,625
Net unrealized gain (loss) on derivatives designated as cash flow hedges	15,514	(7,313)	123,926
Reclassification of net realized loss on derivatives designated as cash flow hedges into earnings	12,540	42,786	9,502
Other comprehensive income (loss)	(37,235)	518,411	962,679
Total comprehensive income	\$ 222,212	\$ 1,140,073	\$ 752,775

NEWCASTLE INVESTMENT CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)

FOR THE YEARS ENDED DECEMBER 31, 2011, 2010 and 2009

(dollars in thousands, except share data)

	Preferred Stock Shares	Amount	Common Stock Shares	Amount	Additional Paid in Capital	Accumulated Deficit	Accumulated Other Comp. Income (Loss)	Total Stock- holders' Equity (Deficit)
<b>Stockholders' equity (deficit) - December 31, 2008</b>	6,100,000	\$ 152,500	52,789,050	\$ 528	\$ 1,033,416	\$ (3,272,403)	\$ (307,573)	\$ (2,393,532)
Issuance of common stock to directors	-	-	123,463	1	104	-	-	105
Reclassification adjustment upon adoption of new impairment	-	-	-	-	-	1,288,924	(1,288,924)	-
Net loss	-	-	-	-	-	(209,904)	-	(209,904)
Other comprehensive income	-	-	-	-	-	-	962,679	962,679
<b>Stockholders' equity (deficit) - December 31, 2009</b>	6,100,000	\$ 152,500	52,912,513	\$ 529	\$ 1,033,520	\$ (2,193,383)	\$ (633,818)	\$ (1,640,652)
Preferred dividends declared	-	-	-	-	-	(19,484)	-	(19,484)
Exchange of preferred stock for common stock and cash	(3,636,679)	(90,917)	9,091,668	91	31,782	43,043	-	(16,001)
Issuance of common stock to directors	-	-	23,003	-	75	-	-	75
Reclassification adjustment upon adoption of new impairment	-	-	-	-	-	-	-	-
Deconsolidation of CDO VII	-	-	-	-	-	-	-	-
Cumulative net loss	-	-	-	-	-	219,175	-	219,175
Unrealized loss on securities	-	-	-	-	-	-	40,715	40,715
Unrealized loss on derivatives designated as cash flow hedges	-	-	-	-	-	-	28,514	28,514
Net income	-	-	-	-	-	621,662	-	621,662
Other comprehensive income	-	-	-	-	-	-	518,411	518,411
<b>Stockholders' equity (deficit) - December 31, 2010</b>	2,463,321	\$ 61,583	62,027,184	\$ 620	\$ 1,065,377	\$ (1,328,987)	\$ (46,178)	\$ (247,585)
Dividends declared	-	-	-	-	-	(48,784)	-	(48,784)
Issuance of common stock	-	-	43,153,825	432	210,415	-	-	210,847
Deconsolidation of CDO V	-	-	-	-	-	-	-	-
Cumulative net loss	-	-	-	-	-	45,072	-	45,072
Unrealized gain on securities	-	-	-	-	-	-	(8,026)	(8,026)
Unrealized loss on derivatives designated as cash flow hedges	-	-	-	-	-	-	18,353	18,353
Net income	-	-	-	-	-	259,447	-	259,447
Other comprehensive loss	-	-	-	-	-	-	(37,235)	(37,235)
<b>Stockholders' equity (deficit) - December 31, 2011</b>	2,463,321	\$ 61,583	105,181,009	\$ 1,052	\$ 1,275,792	\$ (1,073,252)	\$ (73,086)	\$ 192,089

**NEWCASTLE INVESTMENT CORP. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

FOR THE YEARS ENDED DECEMBER 31, 2011, 2010 and 2009

(dollars in thousands)

	Year Ended December 31,		
	2011	2010	2009
<b>Cash Flows From Operating Activities</b>			
Net income (loss)	\$ 259,447	\$ 621,662	\$ (209,904)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities (inclusive of amounts related to discontinued operations):			
Depreciation and amortization	312	262	295
Accretion of discount and other amortization	(44,786)	(18,982)	(28,066)
Interest income in CDOs redirected for reinvestment or CDO bond paydown	(10,279)	(25,975)	(20,984)
Interest income on investments accrued to principal balance	(19,507)	(12,535)	-
Interest expense on debt accrued to principal balance	728	2,964	2,402
Deferred interest received	1,027	44	-
Non-cash directors' compensation	149	75	105
Valuation allowance (reversal) on loans	(15,163)	(339,887)	15,007
Other-than-temporary impairment on securities	15,840	99,029	533,533
Impairment on real estate held-for-sale	433	260	550
Change in fair value of investments in excess mortgage servicing rights	(367)	-	-
Gain on settlement of investments (net) and real estate held-for-sale	(77,310)	(52,307)	(11,438)
Unrealized loss on non-hedge derivatives and hedge ineffectiveness	11,572	36,564	55
Gain on extinguishment of debt	(66,110)	(265,656)	(215,279)
Change in:			
Restricted cash	1,161	151	4,142
Receivables and other assets	(1,342)	4,577	4,370
Due to affiliates	240	(78)	(35)
Accrued expenses and other liabilities	986	(1,278)	(584)
Net cash provided by (used in) operating activities	<u>57,031</u>	<u>48,890</u>	<u>74,169</u>
<b>Cash Flows From Investing Activities</b>			
Principal repayments from repurchased CDO debt	65,912	1,211	-
Principal repayments from CDO securities	10,728	-	-
Return of investments in excess mortgage servicing rights	760	-	-
Principal repayments from loans and non-CDO securities	82,907	64,681	63,934
Purchase of real estate securities	(333,895)	(4,059)	(1,800)
Proceeds from sale of real estate securities	3,885	26,022	131,120
Acquisition of investments in excess mortgage servicing rights	(40,492)	-	-
Acquisition of servicing rights	(2,268)	(100)	-
Purchase of and advances on loans	-	(6,024)	(14,588)
Margin received on derivative instruments	-	5,073	3,550
Return of margin deposits on total rate of return swaps (treated as derivative instruments)	-	-	37
Proceeds (payments) on settlement of derivative instruments	(14,322)	(11,394)	(11,610)
Proceeds from sale of real estate held for sale	650	840	1,350
Distributions of capital from equity method investees	-	193	91
Net cash provided by (used in) investing activities	<u>(226,135)</u>	<u>76,443</u>	<u>172,084</u>

Continued on next page.

NEWCASTLE INVESTMENT CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31, 2011, 2010 and 2009

(dollars in thousands)

	Year Ended December 31,		
	2011	2010	2009
<b>Cash Flows From Financing Activities</b>			
Repurchases of CDO bonds payable	\$ (101,954)	\$ (72,718)	\$ (27,422)
Issuance of other bonds payable	142,736	97,650	-
Repayments of other bonds payable	(204,151)	(143,678)	(77,360)
Borrowings under repurchase agreements	321,020	18,914	-
Repayments of repurchase agreements	(100,012)	(71,491)	(205,163)
Margin deposits under repurchase agreements	-	-	(7,303)
Return of margin deposits under repurchase agreements	-	-	7,586
Issuance of common stock	211,567	-	-
Costs related to issuance of common stock	(905)	-	-
Cash consideration paid in exchange for junior subordinated notes	-	(9,715)	-
Cash consideration paid to redeem preferred stock	-	(16,001)	-
Common stock dividends paid	(23,706)	-	-
Preferred stock dividends paid	(8,371)	(19,484)	-
Payment of deferred financing costs	(1,581)	(1,677)	(200)
Restricted cash returned from refinancing activities	58,293	58,091	82,163
Net cash provided by (used in) financing activities	292,936	(160,109)	(227,699)
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	123,832	(34,776)	18,554
<b>Cash and Cash Equivalents, Beginning of Period</b>	33,524	68,300	49,746
<b>Cash and Cash Equivalents, End of Period</b>	\$ 157,356	\$ 33,524	\$ 68,300
<b>Supplemental Disclosure of Cash Flow Information</b>			
Cash paid during the period for interest expense	\$ 99,096	\$ 125,582	\$ 161,254
<b>Supplemental Schedule of Non-Cash Investing and Financing Activities</b>			
Common stock dividends declared but not paid	\$ 15,777	\$ -	\$ -
Preferred stock dividends declared but not paid	\$ 930	\$ -	\$ -
Issuance of junior subordinated notes in exchange of previously issued trust preferred securities	\$ -	\$ -	\$ 100,000
Common stock issued to redeem preferred stock	\$ -	\$ 28,457	\$ -
Face amount of CDO bonds issued in exchange for previously issued junior subordinated notes of \$52,094	\$ -	\$ 37,625	\$ -
Loans reclassified as other investments	\$ -	\$ 24,907	\$ -

# NEWCASTLE INVESTMENT CORP. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2011, 2010 and 2009

(dollars in tables in thousands, except per share data)

### 1. ORGANIZATION

Newcastle Investment Corp. (and its subsidiaries, “Newcastle”) is a Maryland corporation that was formed in 2002. Newcastle conducts its business through the following segments: (i) investments financed with non-recourse collateralized debt obligations (“non-recourse CDOs”), (ii) unlevered investments in deconsolidated Newcastle CDO debt (“unlevered CDOs”), (iii) unlevered investments in excess mortgage servicing rights (“unlevered excess MSRs”), (iv) investments financed with other non-recourse debt (“non-recourse other”), (v) investments and debt repurchases financed with recourse debt (“recourse”), (vi) other unlevered investments (“unlevered other”) and (vii) corporate. With respect to the non-recourse CDOs and non-recourse other segments, subject to the passing of certain periodic coverage tests, Newcastle is generally entitled to receive the net cash flows from these structures on a periodic basis.

In the fourth quarter of 2011, Newcastle changed the composition of its reportable segments such that the unlevered segment is further broken down into (i) unlevered CDOs, (ii) unlevered excess MSRs and (iii) unlevered other. Management believes the additional segments better reflect its investments in deconsolidated CDOs and its new investment in excess MSRs. Segment information for previously reported periods in the accompanying financial statements has been restated to reflect this change to the composition of its segments.

The following table presents information on shares of Newcastle’s common stock issued subsequent to its formation:

Year	Shares Issued	Range of Issue Prices (1)	Net Proceeds (millions)
Formation - 2006	45,713,817		
2007	7,065,362	\$27.75-\$31.30	\$201.3
2008	9,871	N/A	\$0.1
2009	123,463	N/A	\$0.1
2010	9,114,671	\$3.13	\$28.5
2011	43,153,825	\$4.55 - \$6.00	\$210.8
December 31, 2011	105,181,009		

(1) Exclude prices of shares issued pursuant to the exercise of options and of shares issued to our independent directors. Includes prices of shares issued in exchange for preferred stock.

Newcastle is organized and conducts its operations to qualify as a real estate investment trust (“REIT”) for U.S. federal income tax purposes. As such, Newcastle will generally not be subject to U.S. federal corporate income tax on that portion of its net income that is distributed to stockholders if it distributes at least 90% of its REIT taxable income to its stockholders by prescribed dates and complies with various other requirements.

Newcastle is party to a management agreement (the “Management Agreement”) with FIG LLC (the “Manager”), a subsidiary of Fortress Investment Group LLC (“Fortress”), under which the Manager advises Newcastle on various aspects of its business and manages its day-to-day operations, subject to the supervision of Newcastle’s board of directors. For its services, the Manager receives an annual management fee and incentive compensation, both as defined in, and in accordance with the terms of, the Management Agreement. For a further discussion of the Management Agreement, see Note 10.

In March 2011, Newcastle issued 17,250,000 shares of its common stock in a public offering at a price to the public of \$6.00 per share for net proceeds of approximately \$98.4 million. For the purpose of compensating the Manager for its successful efforts in raising capital for Newcastle, in connection with this offering, Newcastle granted options to the Manager to purchase 1,725,000 shares of Newcastle’s common stock at the public offering price, which were valued at approximately \$7.0 million as of the grant date.

In September 2011, Newcastle issued 25,875,000 shares of its common stock in a public offering at a price to the public of \$4.55 per share for net proceeds of approximately \$112.3 million. Certain principals of Fortress and officers of Newcastle participated in this offering and purchased an aggregate of 1,314,780 shares at the offering price. For the purpose of compensating the Manager for its successful efforts in raising capital for Newcastle, in connection with this offering, Newcastle granted options to the Manager to purchase 2,587,500 shares of Newcastle’s common stock at the public offering price, which were valued at approximately \$5.6 million as of the grant date.

Approximately 4.8 million shares of Newcastle’s common stock were held by Fortress, through its affiliates, and its principals at December 31, 2011. In addition, Fortress, through its affiliates, held options to purchase approximately 6.0 million shares of Newcastle’s common stock at December 31, 2011.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2011, 2010 and 2009

(dollars in tables in thousands, except per share data)

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES****GENERAL**

**Basis of Accounting** – The accompanying consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles ("GAAP"). The consolidated financial statements include the accounts of Newcastle and its consolidated subsidiaries. All significant intercompany transactions and balances have been eliminated. Newcastle consolidates those entities in which it has an investment of 50% or more and has control over significant operating, financial and investing decisions of the entity as well as those entities deemed to be variable interest entities ("VIEs") in which Newcastle is determined to be the primary beneficiary. VIEs are defined as entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. A VIE must be consolidated only by its primary beneficiary, which is defined as the party who, along with its affiliates and agents, has a potentially significant interest in the entity and controls such entity's significant decisions. Newcastle's CDO subsidiaries and its manufactured housing loan financing structures (Note 8) are special purpose entities which are considered VIEs of which Newcastle is the primary beneficiary (except as noted in Note 8). Therefore, the debt issued by such entities is considered a non-recourse secured borrowing of Newcastle. The subprime securitization trusts (Note 5) are VIEs of which Newcastle is not the primary beneficiary. Therefore, the debt issued by such entities is essentially off balance sheet financing.

For entities over which Newcastle exercises significant influence, but which do not meet the requirements for consolidation, Newcastle uses the equity method of accounting whereby it records its share of the underlying income of such entities. Newcastle's investments in equity method investees were not significant at December 31, 2011, 2010 or 2009. Regarding investments in entities over which Newcastle does not meet the requirements for consolidation and does not exercise significant influence, Newcastle records these investments at cost, subject to impairment.

Certain prior period amounts have been reclassified to conform to the current period's presentation.

**Risks and Uncertainties** — In the normal course of business, Newcastle encounters primarily two significant types of economic risk: credit and market. Credit risk is the risk of default on Newcastle's securities, loans, derivatives, and leases that results from a borrower's, derivative counterparty's or lessee's inability or unwillingness to make contractually required payments. Market risk reflects changes in the value of investments in securities, loans and derivatives or in real estate due to changes in interest rates, spreads or other market factors, including the value of the collateral underlying loans and securities and the valuation of real estate held by Newcastle. Management believes that the carrying values of its investments are reasonable taking into consideration these risks along with estimated collateral values, payment histories, and other borrower information.

Additionally, Newcastle is subject to significant tax risks. If Newcastle were to fail to qualify as a REIT in any taxable year, Newcastle would be subject to U.S. federal corporate income tax (including any applicable alternative minimum tax), which could be material. Unless entitled to relief under certain statutory provisions, Newcastle would also be disqualified from treatment as a REIT for the four taxable years following the year during which qualification is lost.

**Use of Estimates** — The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

**Comprehensive Income** — Comprehensive income is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances, excluding those resulting from investments by and distributions to owners. For Newcastle's purposes, comprehensive income represents net income, as presented in the statements of operations, adjusted for unrealized gains or losses on securities available for sale and derivatives designated as cash flow hedges.

The following table summarizes Newcastle's accumulated other comprehensive income:

	December 31,	
	2011	2010
Net unrealized gains (losses) on securities	\$ (2,585)	\$ 70,730
Net unrealized gains (losses) on derivatives designated as cash flow hedges	(70,501)	(116,908)
Accumulated other comprehensive income (loss)	<u>\$ (73,086)</u>	<u>\$ (46,178)</u>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2011, 2010 and 2009

(dollars in tables in thousands, except per share data)

**REVENUE RECOGNITION**

**Real Estate Securities and Loans Receivable** — Newcastle invests in securities, including commercial mortgage backed securities, senior unsecured debt issued by property REITs, real estate related asset backed securities and FNMA/FHLMC securities. Newcastle also invests in loans, including real estate related loans, commercial mortgage loans, residential mortgage loans, manufactured housing loans and subprime mortgage loans. Newcastle determines at acquisition whether loans will be aggregated into pools based on common risk characteristics (credit quality, loan type, and date of origination or acquisition); loans aggregated into pools are accounted for as if each pool were a single loan. Loans receivable are presented in the consolidated balance sheet net of any unamortized discount (or gross of any unamortized premium) and an allowance for loan losses. Discounts or premiums are accreted into interest income on an effective yield or “interest” method, based upon a comparison of actual and expected cash flows, through the expected maturity date of the security or loan. Depending on the nature of the investment, changes to expected cash flows may result in a prospective change to yield or a retrospective change which would include a catch up adjustment. For loans acquired at a discount for credit quality, the difference between contractual cash flows and expected cash flows at acquisition is not accreted (nonaccretable difference). Newcastle discontinues the accretion of discounts and amortization of premium on loans if they are reclassified from held for investment to held for sale. Interest income with respect to non-discounted securities or loans is recognized on an accrual basis. Deferred fees and costs, if any, are recognized as a reduction to the interest income over the terms of the securities or loans using the interest method. Upon settlement of securities and loans, the excess (or deficiency) of net proceeds over the net carrying value of such security or loan is recognized as a gain (or loss) in the period of settlement. Interest income includes prepayment penalties received of \$7.2 million and \$8.2 million in 2010 and 2009, respectively. No prepayments penalties were received in 2011.

**Investments in Excess Mortgage Servicing Rights (“Excess MSR’s”)** — Excess MSR’s are aggregated into pools as applicable; each pool of excess MSR’s investments is accounted for in the aggregate. Excess MSR’s investments are accreted into interest income on an effective yield or “interest” method, based upon the expected excess servicing income through the expected life of the underlying mortgages. Changes to expected cash flows result in a cumulative retrospective adjustment, which will be recorded in the period in which the change in expected cash flows occurs. Under the retrospective method, the interest income recognized for a reporting period would be measured as the difference between the amortized cost basis at the end of the period and the amortized cost basis at the beginning of the period, plus any cash received during the period. The amortized cost basis is calculated as the present value of estimated future cash flows using an effective yield, which is the yield that equates all past actual and current estimated future cash flows to the initial investment. In addition, Newcastle’s policy is to recognize interest income only on excess MSR’s in existing eligible underlying mortgages. The difference between the fair value of excess MSR’s investments and their amortized cost basis is recorded as “Other Income” or “Other Losses”, as applicable. Fair value is generally determined by discounting the expected future cash flows using discount rates that incorporate the market risks and liquidity premium specific to the excess MSR’s investments, and therefore may differ from their effective yields.

**Impairment of Securities and Loans** — Newcastle continually evaluates securities and loans for impairment. Securities and loans are considered to be other-than-temporarily impaired, for financial reporting purposes, generally when it is probable that Newcastle will be unable to collect all principal or interest when due according to the contractual terms of the original agreements, or, for securities or loans purchased at a discount for credit quality or that represent retained beneficial interests in securitizations, when Newcastle determines that it is probable that it will be unable to collect as anticipated. The evaluation of a security’s estimated cash flows includes the following, as applicable: (i) review of the credit of the issuer or the borrower, (ii) review of the credit rating of the security, (iii) review of the key terms of the security or loan, (iv) review of the performance of the loan or underlying loans, including debt service coverage and loan to value ratios, (v) analysis of the value of the collateral for the loan or underlying loans, (vi) analysis of the effect of local, industry and broader economic factors, and (vii) analysis of historical and anticipated trends in defaults and loss severities for similar securities or loans. Furthermore, Newcastle must have the intent and ability to hold loans whose fair value is below carrying value until such fair value recovers, or until maturity, or else a write down to fair value must be recorded. Similarly for securities, Newcastle must record a write down if we have the intent to sell a given security in an unrealized loss position, or if it is more likely than not that we will be required to sell such a security. Upon determination of impairment, Newcastle establishes specific valuation allowances for loans or records a direct write down for securities based on the estimated fair value of the security or underlying collateral using a discounted cash flow analysis or based on an observable market value. Newcastle also establishes allowances for estimated unidentified incurred losses on pools of loans. The allowance for each loan is maintained at a level believed adequate by management to absorb probable losses, based on periodic reviews of actual and expected losses. It is Newcastle’s policy to establish an allowance for uncollectible interest on performing securities or loans that are past due more than 90 days or sooner when, in the judgment of management, the probability of collection of interest is deemed to be insufficient to warrant further accrual. Upon such a determination, those loans are deemed to be non-performing and put on nonaccrual status. Actual losses may differ from

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Newcastle's estimates. Newcastle may resume accrual of income on a security or loan if, in management's opinion, full collection is probable. Subsequent to a determination of impairment, and a related write down, income is accrued on an effective yield method from the new carrying value to the related expected cash flows, with cash received treated as a reduction of basis. Newcastle charges off the corresponding loan allowance when it determines the loans to be uncollectable.

**Gain (Loss) on Settlement of Investments, Net and Other Income (Loss), Net** – These items are comprised of the following:

	Year-Ended December 31,		
	2011	2010	2009
Gain (loss) on settlement of investments, net			
Gain on settlement of real estate securities	\$ 81,434	\$ 64,778	\$ 29,663
Loss on settlement of real estate securities	(5,091)	(9,192)	(18,644)
Gain on repayment/disposition of loans held for sale	1,838	-	526
Loss on repayment/disposition of loans held for sale	-	-	(111)
Realized gain (loss) of termination of derivative instruments	-	(3,279)	4
	<u>\$ 78,181</u>	<u>\$ 52,307</u>	<u>\$ 11,438</u>
Other income (loss), net			
Gain (loss) on non-hedge derivative instruments	\$ 3,284	\$ (1,240)	\$ 15,446
Unrealized gain (loss) recognized upon de-designation of hedges	(13,939)	(35,905)	(15,223)
Increase in fair value of investments in excess mortgage servicing rights	367	-	-
Hedge ineffectiveness	(917)	580	(278)
Equity in earnings of equity method investees	272	94	420
Collateral management fee income, net	2,432	475	-
Other income (loss)	-	320	317
	<u>\$ (8,501)</u>	<u>\$ (35,676)</u>	<u>\$ 682</u>

### EXPENSE RECOGNITION

**Interest Expense** — Newcastle finances its investments using both fixed and floating rate debt, including securitizations, loans, repurchase agreements, and other financing vehicles. Certain of this debt has been issued at discounts. Discounts are accreted into interest expense on the effective yield or "interest" method, based upon a comparison of actual and expected cash flows, through the expected maturity date of the financing.

**Deferred Costs and Interest Rate Cap Premiums** — Deferred costs consist primarily of costs incurred in obtaining financing which are amortized into interest expense over the term of such financing using the interest method. Interest rate cap premiums, if any, are included in Derivative Assets, and are amortized as described below.

**Derivatives and Hedging Activities** — All derivatives are recognized as either assets or liabilities on the balance sheet and measured at fair value. Newcastle reports the fair value of derivative instruments gross of cash paid or received pursuant to credit support agreements and fair value is reflected on a net counterparty basis when Newcastle believes a legal right of offset exists under an enforceable netting agreement. Fair value adjustments affect either stockholders' equity or net income depending on whether the derivative instrument qualifies as a hedge for accounting purposes and, if so, the nature of the hedging activity. For those derivative instruments that are designated and qualify as hedging instruments, Newcastle designates the hedging instrument, based upon the exposure being hedged, as either a cash flow hedge, a fair value hedge or a hedge of a net investment in a foreign operation.

Derivative transactions are entered into by Newcastle solely for risk management purposes, except for total rate of return swaps. Such total rate of return swaps are essentially financings of certain reference assets which are treated as derivatives for accounting purposes. The decision of whether or not a given transaction/position (or portion thereof) is hedged is made on a case-by-case basis, based on the risks involved and other factors as determined by senior management, including restrictions imposed by the Code among others. In determining whether to hedge a risk, Newcastle may consider whether other assets, liabilities, firm commitments and anticipated transactions already offset or reduce the risk. All transactions undertaken as hedges are entered into with a view towards minimizing the potential for economic losses that could be incurred by Newcastle. Generally, all derivatives entered into are intended to qualify as hedges under GAAP, unless specifically stated otherwise. To this end, terms of hedges are matched closely to the terms of hedged items.

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Description of the risks being hedged

- 1) Interest rate risk, existing debt obligations – Newcastle has hedged (and may continue to hedge, when feasible and appropriate) the risk of interest rate fluctuations with respect to its borrowings, regardless of the form of such borrowings, which require payments based on a variable interest rate index. Newcastle generally intends to hedge only the risk related to changes in the benchmark interest rate (LIBOR or a Treasury rate). In order to reduce such risks, Newcastle may enter into swap agreements whereby Newcastle would receive floating rate payments in exchange for fixed rate payments, effectively converting the borrowing to fixed rate. Newcastle may also enter into cap agreements whereby, in exchange for a premium, Newcastle would be reimbursed for interest paid in excess of a certain cap rate.
- 2) Interest rate risk, anticipated transactions – Newcastle may hedge the aggregate risk of interest rate fluctuations with respect to anticipated transactions, primarily anticipated borrowings. The primary risk involved in an anticipated borrowing is that interest rates may increase between the date the transaction becomes probable and the date of consummation. Newcastle generally intends to hedge only the risk related to changes in the benchmark interest rate (LIBOR or a Treasury rate). This is generally accomplished through the use of interest rate swaps.

Cash flow hedges

To qualify for cash flow hedge accounting, interest rate swaps and caps must meet certain criteria, including (1) the items to be hedged expose Newcastle to interest rate risk, (2) the interest rate swaps or caps are highly effective in reducing Newcastle's exposure to interest rate risk, and (3) with respect to an anticipated transaction, such transaction is probable. Correlation and effectiveness are periodically assessed based upon a comparison of the relative changes in the fair values or cash flows of the interest rate swaps and caps and the items being hedged or using regression analysis on an ongoing basis to assess retrospective and prospective hedge effectiveness.

For derivative instruments that are designated and qualify as a cash flow hedge (i.e. hedging the exposure to variability in expected future cash flows that is attributable to a particular risk), the effective portion of the gain or loss, and net payments received or made, on the derivative instrument are reported as a component of other comprehensive income and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. The remaining gain or loss on the derivative instrument in excess of the cumulative change in the present value of future cash flows of the hedged item, if any, is recognized in current earnings during the period of change. The premiums paid for interest rate caps, treated as cash flow hedges, are amortized into interest expense based on the estimated value of such cap for each period covered by such cap.

With respect to interest rate swaps which have been designated as hedges of anticipated financings, periodic net payments are recognized currently as adjustments to interest expense; any gain or loss from fluctuations in the fair value of the interest rate swaps is recorded as a deferred hedge gain or loss in accumulated other comprehensive income and treated as a component of the anticipated transaction. In the event the anticipated refinancing failed to occur as expected, the deferred hedge credit or charge would be recognized immediately in earnings. Newcastle's hedges of such financings were terminated upon the consummation of such financings.

Newcastle has dedesignated certain of its hedge derivatives, and in some cases redesignated all or a portion thereof as hedges. As a result of these dedesignations, in the cases where the originally hedged items were still owned by Newcastle, the unrealized gain or loss was recorded in OCI as a deferred hedge gain or loss and is being amortized over the life of the hedged item.

Non-Hedge Derivatives

With respect to interest rate swaps and caps that have not been designated as hedges, any net payments under, or fluctuations in the fair value of, such swaps and caps have been recognized currently in Other Income (Loss). These derivatives may, to some extent, be economically effective as hedges.

Newcastle's derivative financial instruments contain credit risk to the extent that its bank counterparties may be unable to meet the terms of the agreements. Newcastle reduces such risk by limiting its counterparties to major financial institutions. In addition, the potential risk of loss with any one party resulting from this type of credit risk is monitored. Management does not expect any material losses as a result of default by other parties. Newcastle does not require collateral for the derivative financial instruments within its CDO financing structures. Newcastle's major derivative counterparties include Bank of America, Credit Suisse and Wells Fargo.

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**Management Fees to Affiliate** — These represent amounts due to the Manager pursuant to the Management Agreement. For further information on the Management Agreement, see Note 10.

#### BALANCE SHEET MEASUREMENT

**Investment in Real Estate Securities** — Newcastle has classified its investments in securities as available for sale. Securities available for sale are carried at market value with the net unrealized gains or losses reported as a separate component of accumulated other comprehensive income, to the extent impairment losses are considered temporary. At disposition, the net realized gain or loss is determined on the basis of the cost of the specific investments and is included in earnings. Unrealized losses on securities are charged to earnings if they reflect a decline in value that is other-than-temporary, as described above.

**Investment in Loans** — Loans receivable are presented net of any unamortized discount (or gross of any unamortized premium), including any fees received, and an allowance for loan losses. Loans which Newcastle does not have the intent and ability to hold into the foreseeable future are considered held-for-sale and are carried at the lower of amortized cost or market value.

**Investments in Excess Mortgage Servicing Rights (Excess MSR)** — Upon acquisition, Newcastle has elected to record each of such investments at fair value. Newcastle elected to record its investments in excess MSR at fair value in order to provide users of the financial statements with better information regarding the effects of prepayment risk and other market factors on the excess MSR. Under this election, Newcastle records a valuation adjustment on its excess MSR investments on a quarterly basis to recognize the changes in fair value in net income as described in Revenue Recognition – Investments in Excess Mortgage Servicing Rights above. As of December 31, 2011, all excess MSR investments are classified as held-for-investment as Newcastle has the intent and ability to hold the investments for the foreseeable future.

**Investment in Operating Real Estate** — Operating real estate is recorded at cost less accumulated depreciation. Depreciation is computed on a straight-line basis. Buildings are depreciated over 40 years. Major improvements are capitalized and depreciated over their estimated useful lives. Fees and costs incurred in the successful negotiation of leases are deferred and amortized on a straight-line basis over the terms of the respective leases. Expenditures for repairs and maintenance are expensed as incurred. Newcastle reviews its real estate assets for impairment annually or whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. Long-lived assets to be disposed of by sale, which meet certain criteria, are reclassified to Real Estate Held for Sale and measured at the lower of their carrying amount or fair value less costs of sale. The results of operations for such an asset, assuming such asset qualifies as a “component of an entity” as defined, are retroactively reclassified to Income (Loss) from Discontinued Operations for all periods presented.

**Cash and Cash Equivalents and Restricted Cash** — Newcastle considers all highly liquid short term investments with maturities of 90 days or less when purchased to be cash equivalents. Substantially all amounts on deposit with major financial institutions exceed insured limits. Restricted cash consisted of:

	December 31,	
	2011	2010
Held in CDOs pending reinvestment	\$ 94,781	\$ 150,185
CDO bond sinking funds	1,897	2,939
CDO trustee accounts	1,812	3,881
Derivative margin accounts	6,550	-
	<u>\$ 105,040</u>	<u>\$ 157,005</u>

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Supplemental non-cash investing and financing activities relating to CDOs are disclosed below:

	Year Ended December 31,		
	2011	2010	2009
Restricted cash generated from sale of securities	\$ 336,911	\$ 249,549	\$ 132,578
Restricted cash generated from sale of real estate related loans	\$ 125,141	\$ 53,020	\$ 26,961
Restricted cash generated from paydowns on securities and loans	\$ 546,752	\$ 511,276	\$ 433,918
Restricted cash generated from margin collateral received	\$ 6,550	\$ -	\$ -
Restricted cash used for purchases of real estate securities	\$ 427,826	\$ 368,893	\$ 297,632
Restricted cash used for purchases of real estate related loans	\$ 384,850	\$ 107,708	\$ -
Restricted cash used for repayments of CDO bonds payable	\$ 101,687	\$ 202,037	\$ 59,741
Restricted cash used for repurchases of CDO bonds payable and other bonds payable	\$ 3,213	\$ 143,046	\$ 2,525
Restricted cash used for purchases of derivative instruments	\$ -	\$ 5,187	\$ -
CDO V deconsolidation:			
Real estate securities	\$ 262,617	\$ -	\$ -
Restricted cash	\$ 37,988	\$ -	\$ -
Derivative liabilities	\$ 20,257	\$ -	\$ -
CDO bonds payable	\$ 336,046	\$ -	\$ -

**Stock Options** — The fair value of the options issued as compensation to the Manager for its successful efforts in raising capital for Newcastle was recorded as an increase in stockholders' equity with an offsetting reduction of capital proceeds received. Options granted to Newcastle's directors were accounted for using the fair value method.

**Preferred Stock** — Newcastle's accounting policy for its preferred stock is described in Note 9.

**Accretion of Discount and Other Amortization** — As reflected on the Consolidated Statements of Cash Flows, this item is comprised of the following:

	2011	2010	2009
Accretion of net discount on securities and loans	\$(45,387)	\$(26,934)	\$(52,925)
Amortization of net discount on debt obligations	(822)	337	7,004
Amortization of deferred financing costs and interest rate cap premiums	3,740	3,432	8,409
Amortization of net deferred hedge (gains) and losses - debt	(2,317)	4,183	9,446
	<u>\$(44,786)</u>	<u>\$(18,982)</u>	<u>\$(28,066)</u>

**Securitization of Subprime Mortgage Loans** — Newcastle's accounting policy for its securitization of subprime mortgage loans is disclosed in Note 5.

**Recent Accounting Pronouncements** — In April 2009, the FASB issued new guidance which (i) requires disclosures about the fair value of financial instruments on an interim basis, (ii) changes the guidance for determining, recording and disclosing other-than-temporary impairment, and (iii) provides additional guidance for estimating fair value when the volume or level of activity for an asset or liability have significantly decreased. This guidance was effective for Newcastle as of April 1, 2009. It had a significant impact on Newcastle's disclosures, but no material impact on its financial condition, liquidity, or results of operations upon adoption. A reclassification adjustment of \$1.3 billion of loss from Accumulated Deficit to Accumulated Other Comprehensive Income (Loss) was recorded at adoption but had no net effect on equity. Post-adoption impairment determinations, including the analysis performed at December 31, 2011, are performed using this new guidance and may result in materially different conclusions than would have been reached under prior guidance.

In June 2009, the FASB issued new guidance on transfers of financial assets which eliminates the concept of qualified special purpose entities ("QSPEs"), changes the requirements for reporting a transfer of a portion of financial assets as a sale, clarifies other sale accounting criteria and changes the initial measurement of a transferor's interest in transferred financial assets. Furthermore, it requires additional disclosures. This guidance is effective for fiscal years beginning after

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November 15, 2009. The adoption of this guidance did not have a material impact on Newcastle's financial position, liquidity or results of operations.

In June 2009, the FASB issued new guidance which changes the definition of a variable interest entity ("VIE") and changes the methodology to determine who is the primary beneficiary of, or in other words who consolidates, a VIE. Furthermore, it eliminates the scope exception for QSPEs, which are now subject to the VIE consolidation rules. This guidance is effective for fiscal years beginning after November 15, 2009. Generally, the changes are expected to cause more entities to be defined as VIE's and to require consolidation by the entity that exercises day-to-day control over a VIE, such as servicers and collateral managers. The adoption of this guidance led to the deconsolidation of one of Newcastle's CDOs, CDO VII (Note 8). The deconsolidation reduced Newcastle's gross assets and gross liabilities by \$149.4 million and \$437.8 million, respectively, and increased equity by \$288.4 million. The deconsolidation also reduced revenues and expenses, but its impact was not material to the net income applicable to common stockholders.

In May 2011, the FASB issued new guidance regarding the measurement and disclosure of fair value, which will become effective for Newcastle on January 1, 2012. Newcastle has not yet completed its assessment of the potential impact of this guidance.

In June 2011, the FASB issued a new accounting standard that eliminates the current option to report other comprehensive income and its components in the statement of stockholders' equity. Instead, an entity will be required to present items of net income and other comprehensive income in one continuous statement or in two separate, but consecutive, statements. Newcastle has early-adopted this accounting standard and has opted to present two separate statements.

The FASB has recently issued or discussed a number of proposed standards on such topics as consolidation, the definition of an investment company, financial statement presentation, revenue recognition, leases, financial instruments, hedging, and contingencies. Some of the proposed changes are significant and could have a material impact on Newcastle's reporting. Newcastle has not yet fully evaluated the potential impact of these proposals, but will make such an evaluation as the standards are finalized.

### **3. SEGMENT REPORTING AND VARIABLE INTEREST ENTITIES**

Newcastle conducts its business through the following segments: (i) investments financed with non-recourse collateralized debt obligations ("non-recourse CDOs"), (ii) unlevered investments in deconsolidated Newcastle CDO debt ("unlevered CDOs"), (iii) unlevered investments in excess mortgage servicing rights ("unlevered excess MSRs"), (iv) investments financed with other non-recourse debt ("non-recourse other"), (v) investments and debt repurchases financed with recourse debt ("recourse"), (vi) other unlevered investments ("unlevered other") and (vii) corporate. With respect to the non-recourse CDOs and non-recourse other segments, subject to the passing of certain periodic coverage tests, Newcastle is generally entitled to receive the net cash flows from these structures on a periodic basis.

In the fourth quarter of 2011, Newcastle changed the composition of its reportable segments such that the unlevered segment is further broken down into (i) unlevered CDOs, (ii) unlevered excess MSRs and (iii) unlevered other. Management believes the additional segments better reflect its investments in deconsolidated CDOs and its new investment in excess MSRs. Segment information for previously reported periods in the accompanying financial statements has been restated to reflect this change to the composition of its segments.

The corporate segment consists primarily of interest income on short term investments, general and administrative expenses, interest expense on the junior subordinated notes payable (Note 8) and management fees pursuant to the Management Agreement (Note 10).

NEWCASTLE INVESTMENT CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31, 2011, 2010 and 2009

(dollars in thousands)

Summary financial data on Newcastle's segments is given below, together with a reconciliation to the same data for Newcastle as a whole:

	Non- Recourse			Non- Recourse			Inter-segment			Total
	CDOs (A)	Unlevered CDOs (B)	Unlevered Excess MSRs	Recourse Other (A)(C)	Recourse (D)	Unlevered Other (E)	Corporate	Elimination (F)		
Year Ended December 31, 2011										
Interest income	\$ 218,131	\$ 344	\$ 1,260	\$ 73,364	\$ 2,234	\$ 2,636	\$ 167	\$ (5,840)	\$ 292,296	
Interest expense	86,110	-	-	52,801	693	5	3,815	(5,389)	138,035	
Net interest income (expense)	132,021	344	1,260	20,563	1,541	2,631	(3,648)	(451)	154,261	
Impairment (reversal)	(3,876)	-	-	8,036	-	(3,483)	-	-	677	
Other income (loss)	126,891	3,739	367	2,561	-	2,232	-	-	135,790	
Expenses	1,058	-	1,055	3,576	-	19	24,525	-	30,233	
Income (loss) from continuing operations	261,730	4,083	572	11,512	1,541	8,327	(28,173)	(451)	259,141	
Income (loss) from discontinued operations	-	-	-	(88)	-	(57)	-	451	306	
Net income (loss)	261,730	4,083	572	11,424	1,541	8,270	(28,173)	-	259,447	
Preferred dividends	-	-	-	-	-	-	(5,580)	-	(5,580)	
Income (loss) applicable to common stockholders	\$ 261,730	\$ 4,083	\$ 572	\$ 11,424	\$ 1,541	\$ 8,270	\$ (33,753)	\$ -	\$ 253,867	
December 31, 2011										
Investments	\$ 2,408,252	\$ 3,940	\$ 43,971	\$ 783,777	\$ 244,916	\$ 18,751	\$ -	\$ (143,018)	\$ 3,360,589	
Cash and restricted cash	105,040	-	-	-	-	9	157,347	-	262,396	
Derivative assets	1,954	-	-	-	-	-	-	-	1,954	
Other assets	23,203	8	-	116	593	2,085	1,208	(353)	26,860	
Total assets	2,538,449	3,948	43,971	783,893	245,509	20,845	158,555	(143,371)	3,651,799	
Debt	(2,410,151)	-	-	(748,118)	(233,194)	-	(51,248)	143,018	(3,299,693)	
Derivative liabilities	(119,320)	-	-	-	-	-	-	-	(119,320)	
Other liabilities	(12,705)	-	(4,186)	(3,407)	(23)	(49)	(20,680)	353	(40,697)	
Total liabilities	(2,542,176)	-	(4,186)	(751,525)	(233,217)	(49)	(71,928)	143,371	(3,459,710)	
Preferred stock	-	-	-	-	-	-	(61,583)	-	(61,583)	
GAAP book value	\$ (3,727)	\$ 3,948	\$ 39,785	\$ 32,368	\$ 12,292	\$ 20,796	\$ 25,044	\$ -	\$ 130,506	

**NEWCASTLE INVESTMENT CORP. AND SUBSIDIARIES**

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Year Ended	Non-							Total	
	December 31, 2010	Recourse CDOs (A)	Unlevered CDOs (B)	Non-Recourse Other (A)(C)	Recourse	Unlevered Other (E)	Corporate Elimination (F)		Inter-segment Elimination (F)
Interest income	\$ 226,717	\$ -	\$ -	\$ 72,773	\$ 976	\$ 1,653	\$ 68	\$ (1,915)	\$ 300,272
Interest expense	108,437	-	-	60,635	656	356	3,980	(1,845)	172,219
Net interest income (expense)	118,280	-	-	12,138	320	1,297	(3,912)	(70)	128,053
Impairment, net of the reversal of prior valuation allowances on loans	(173,223)	16	-	(38,561)	(60)	(29,030)	-	-	(240,858)
Other income (loss)	289,158	475	-	(5,491)	(663)	(1,269)	77	-	282,287
Expenses	1,483	-	-	3,149	4	(197)	25,089	-	29,528
Income (loss) from continuing operations	579,178	459	-	42,059	(287)	29,255	(28,924)	(70)	621,670
Income (loss) from discontinued operations	-	-	-	(271)	-	193	-	70	(8)
Net income (loss)	579,178	459	-	41,788	(287)	29,448	(28,924)	-	621,662
Preferred dividends	-	-	-	-	-	-	(7,453)	-	(7,453)
Excess of carrying amount of exchanged preferred stock over fair value of consideration paid	-	-	-	-	-	-	43,043	-	43,043
Income (loss) applicable to common stockholders	\$ 579,178	\$ 459	\$ -	\$ 41,788	\$ (287)	\$ 29,448	\$ 6,666	\$ -	\$ 657,252

December 31, 2010

Investments	\$ 2,713,044	\$ -	\$ -	\$ 740,596	\$ -	\$ 39,397	\$ -	\$ (34,185)	\$ 3,458,852
Cash and restricted cash	157,005	-	-	-	-	12	33,512	-	190,529
Derivative assets	7,067	-	-	-	-	-	-	-	7,067
Other assets	29,110	7	-	96	-	143	1,307	-	30,663
Total assets	2,906,226	7	-	740,692	-	39,552	34,819	(34,185)	3,687,111
Debt	(3,029,273)	-	-	(694,787)	(4,683)	-	(51,253)	34,185	(3,745,811)
Derivative liabilities	(160,660)	-	-	(16,201)	-	-	-	-	(176,861)
Other liabilities	(6,353)	-	-	(2,092)	(2)	(96)	(3,481)	-	(12,024)
Total liabilities	(3,196,286)	-	-	(713,080)	(4,685)	(96)	(54,734)	34,185	(3,934,696)
Preferred stock	-	-	-	-	-	-	(61,583)	-	(61,583)
GAAP book value	\$ (290,060)	\$ 7	\$ -	\$ 27,612	\$ (4,685)	\$ 39,456	\$ (81,498)	\$ -	\$ (309,168)

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Year Ended December 31, 2009	Non-Recourse CDOs (A)		Non-Recourse Other		Recourse		Unlevered Other		Corporate		Total
	Recourse CDOs (A)	Other	Recourse	Other	Recourse	Other	Corporate	Corporate	Total		
Interest income	\$ 275,938	\$ 76,868	\$ 7,416	\$ 1,543	\$ 101	\$ 361,866					
Interest expense	140,674	65,734	3,763	-	8,239	218,410					
Net interest income (expense)	135,264	11,134	3,653	1,543	(8,138)	143,456					
Impairment, net of reversal of prior valuation allowances on loans	513,234	(24,212)	50,142	9,376	-	548,540					
Other income (loss)	216,128	6,650	4,311	309	1	227,399					
Expenses	1,619	3,386	33	220	26,643	31,901					
Income (loss) from continuing operations	(163,461)	38,610	(42,211)	(7,744)	(34,780)	(209,586)					
Income (loss) from discontinued operations	-	-	-	(318)	-	(318)					
Net income (loss)	(163,461)	38,610	(42,211)	(8,062)	(34,780)	(209,904)					
Preferred dividends	-	-	-	-	(13,501)	(13,501)					
Income (loss) applicable to common stockholders	\$ (163,461)	\$ 38,610	\$ (42,211)	\$ (8,062)	\$ (48,281)	\$ (223,405)					

(A) Assets held within CDOs and other non-recourse structures are not available to satisfy obligations outside of such financings, except to the extent Newcastle receives net cash flow distributions from such structures. Furthermore, creditors or beneficial interest holders of these structures have no recourse to the general credit of Newcastle. Therefore, Newcastle's exposure to the economic losses from such structures is limited to its invested equity in them and economically their book value cannot be less than zero. Therefore, impairment recorded in excess of Newcastle's investment, which results in negative GAAP book value for a given non-recourse financing structure, cannot economically be incurred and will eventually be reversed through amortization, sales at gains, or as gains at the deconsolidation or termination of such non-recourse financing structure.

(B) Represents unlevered investments in CDO securities issued by Newcastle. These CDOs have been deconsolidated as Newcastle does not have the power to direct the relevant activities of the CDOs.

(C) The following table summarizes the investments and debt in the other non-recourse segment:

	December 31, 2011				December 31, 2010			
	Investments		Debt		Investments		Debt	
	Outstanding Face Amount	Carrying Value	Outstanding Face Amount*	Carrying Value*	Outstanding Face Amount	Carrying Value	Outstanding Face Amount*	Carrying Value*
Manufactured housing loan portfolio I	\$ 135,209	\$ 112,316	\$ 107,032	\$ 97,631	\$ 151,281	\$ 124,974	\$ 123,275	\$ 113,218
Manufactured housing loan portfolio II	178,603	175,120	143,869	142,589	212,036	203,053	171,972	171,738
Residential mortgage loans	56,377	40,380	54,842	53,771	N/A	N/A	N/A	N/A
Subprime mortgage loans subject to call options	406,217	404,723	406,217	404,723	406,217	403,793	406,217	403,793
Real estate securities	67,965	43,497	47,697	43,404	N/A	N/A	N/A	N/A
Operating real estate	N/A	7,741	6,000	6,000	N/A	8,776	6,000	6,038
	\$ 844,371	\$ 783,777	\$ 765,657	\$ 748,118	\$ 769,534	\$ 740,596	\$ 707,464	\$ 694,787

\* As of December 31, 2011 and December 31, 2010, aggregate face amounts of \$157.0 million and \$42.9 million (carrying values of \$143.0 million and \$34.2 million), respectively, of debt represents financing provided by the CDO segment (and included as investments in the CDO segment), which is eliminated upon consolidation.

(D) The \$233.2 million of recourse debt is comprised of (i) a \$231.0 million repurchase agreement, secured by \$244.9 million carrying value of FNMA/FHLMC securities and (ii) a \$2.2 million repurchase agreement, secured by \$29.1 million face amount of senior notes issued by Newcastle CDO VI, which was repurchased by Newcastle in December 2010 and eliminated in consolidation.

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(E) The following table summarizes the investments in the unlevered other segment:

	December 31, 2011			December 31, 2010		
	Outstanding	Carrying	Number of	Outstanding	Carrying	Number of
	Face Amount	Value	Investments	Face Amount	Value	Investments
Real estate securities	\$ 183,507	\$ 7,614	25	\$ 186,081	\$ 600	25
Real estate related loans	24,543	6,366	1	97,106	32,475	* 5
Residential mortgage loans	5,227	2,687	170	1,169	298	27
Other investments	N/A	6,024	1	N/A	6,024	1
	<u>\$ 213,277</u>	<u>\$ 22,691</u>	<u>197</u>	<u>\$ 284,356</u>	<u>\$ 39,397</u>	<u>58</u>

\*A mezzanine loan with a \$28.0 million of face amount and carrying value was repaid in full in February 2011.

(F) Represents the elimination of investments and financings and their related income and expenses between the CDO segment and other non-recourse segment as the corresponding inter-segment investments and financings are presented on a gross basis within each of these segments.

**Variable Interest Entities (“VIEs”)**

The VIEs in which Newcastle has a significant interest include (i) Newcastle’s CDOs, in which Newcastle has been determined to be the primary beneficiary and therefore consolidates them (with the exception of CDOs V and VII as described below), since it has the power to direct the activities that most significantly impact the CDOs’ economic performance and would absorb a significant portion of their expected losses and receive a significant portion of their expected residual returns, and (ii) the manufactured housing loan financing structures, which are similar to the CDOs in analysis. Newcastle’s CDOs and manufactured housing loan financings are held in special purpose entities whose debt is treated as non-recourse secured borrowings of Newcastle. Newcastle’s subprime securitizations are also considered VIEs, but Newcastle does not control their activities and no longer receives a significant portion of their returns. These subprime securitizations were not consolidated under the current or prior guidance.

In addition, Newcastle’s investments in CMBS, CDO securities and loans may be deemed to be variable interests in VIEs, depending on their structure. Newcastle is not obligated to provide, nor has it provided, any financial support to these VIEs. Newcastle monitors these investments and, to the extent Newcastle determines that it potentially owns a majority of the currently controlling class, it analyzes them for potential consolidation. As of December 31, 2011, Newcastle has not consolidated these potential VIEs due to the determination that, based on the nature of Newcastle’s investments and the provisions governing these structures, Newcastle does not have the power to direct the activities that most significantly impact their economic performance.

On January 1, 2010, as a result of the adoption of the new guidance, Newcastle deconsolidated a non-recourse financing structure, CDO VII. Newcastle determined that it does not have the current power to direct the relevant activities of CDO VII as an event of default had occurred and we may be removed as the collateral manager by a single party. The deconsolidation reduced Newcastle’s gross assets by \$149.4 million, reduced liabilities by \$437.8 million and increased equity by \$288.4 million. The deconsolidation also reduced revenues and expenses, but its impact was not material to the net income applicable to common stockholders.

In April 2011, Newcastle sold its retained interests in Newcastle CDO VII, a non-consolidated VIE of Newcastle. As a result of the sale of Newcastle’s retained interests in CDO VII and the subsequent liquidation of the VIE, CDO VII has been removed from Newcastle’s non-consolidated VIE disclosure.

On June 17, 2011, Newcastle deconsolidated a non-recourse financing structure, CDO V. Newcastle determined that it does not currently have the power to direct the relevant activities of CDO V as an event of default had occurred and Newcastle may be removed as the collateral manager by a single party. The deconsolidation has reduced Newcastle’s gross assets by \$301.6 million, reduced liabilities by \$357.0 million and increased equity by \$55.4 million. The deconsolidation also reduced revenues and expenses from June 17, 2011 onwards, but its impact was not material to net income applicable to common stockholders.

Newcastle has interests in the following unconsolidated VIE at December 31, 2011, in addition to the subprime securitizations which are described in Note 4:

Entity	Gross Assets (A)	Debt (B)	Carrying Value of Newcastle's
			Investment (C)
CDO V	\$ 303,392	\$ 304,068	\$ 3,940

(A) Face amount.

(B) Includes \$41.6 million face amount of debt owned by Newcastle with a carrying value of \$3.9 million at December 31, 2011.

(C) This amount represents Newcastle’s maximum exposure to loss from this entity, which was its fair value at December 31, 2011, related to \$5.5 million face amount of CDO V Class I notes.

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**4. REAL ESTATE SECURITIES**

The following is a summary of Newcastle's real estate securities at December 31, 2011 and 2010, all of which are classified as available for sale and are, therefore, reported at fair value with changes in fair value recorded in other comprehensive income, except for securities that are other-than-temporarily impaired.

Asset Type	Outstanding Face Amount	Before Impairment	Amortized Cost Basis			Gross Unrealized			Carrying Value (B)	Number of Securities	Rating (C)	Coupon	Yield	Maturity (Years) (D)	Principal Subordination (E)
			Other-Than- Temporary- Impairment (A)	After Impairment	Impairment (A)	Impairment (A)	Impairment (A)	Losses							
December 31, 2011															
CMBS-Conduit	\$1,344,819	\$1,143,910	\$ (202,164)	\$ 941,746	\$ 91,583	\$ (76,424)	\$ 956,905	169	BB+	5.61%	11.03%	4.2	10.8%		
CMBS- Single Borrower	186,088	180,874	(12,364)	168,510	3,121	(14,366)	157,265	33	BB	5.05%	6.25%	3.6	6.7%		
CMBS-Large Loan	14,970	14,190	-	14,190	519	(61)	14,648	2	BBB+	5.15%	8.89%	1.2	7.5%		
REIT Debt	137,393	136,704	(773)	135,931	5,060	(5,695)	135,296	20	BB+	5.83%	5.72%	2.4	N/A		
ABS-Subprime (F)	246,014	209,838	(86,815)	123,023	14,481	(8,882)	128,622	63	B	1.22%	10.16%	6.9	32.5%		
ABS-Manufactured Housing	30,232	29,454	-	29,454	1,247	(154)	30,547	7	BBB+	6.61%	7.54%	4.2	41.6%		
ABS-Franchise	23,115	21,598	(11,133)	10,465	215	(3,120)	7,560	7	BB+	3.58%	4.56%	11.0	21.9%		
FNMA/FHLMC	232,355	243,385	-	243,385	1,715	(185)	244,915	31	AAA	2.37%	1.63%	4.6	N/A		
CDO (G)	206,150	82,486	(14,861)	67,625	149	(11,788)	55,986	13	CC+	3.03%	8.05%	1.5	N/A		
Total/Average (H)	\$2,421,136	\$2,062,439	\$ (328,110)	\$1,734,329	\$118,090	\$ (120,675)	\$1,731,744	345	BB+	4.60%	8.54%	4.2			
December 31, 2010															
CMBS-Conduit	\$1,531,520	\$1,308,320	\$ (455,985)	\$ 852,335	\$161,695	\$ (66,346)	\$ 947,684	196	BB	5.70%	11.60%	3.3	9.8%		
CMBS- Single Borrower	409,190	397,567	(14,853)	382,714	3,484	(58,431)	327,767	59	BB-	3.96%	5.65%	2.5	7.5%		
CMBS-Large Loan	30,315	30,311	-	30,311	-	(5,028)	25,283	6	BBB+	1.69%	1.74%	1.1	22.4%		
REIT Debt	317,413	316,085	-	316,085	17,809	(4,924)	328,970	40	BB+	6.15%	5.98%	3.5	N/A		
ABS-Subprime	353,306	353,432	(191,968)	161,464	23,752	(7,210)	178,006	88	B-	1.54%	11.78%	5.0	24.2%		
ABS-Manufactured Housing	35,137	34,101	-	34,101	1,498	(384)	35,215	7	BBB+	6.65%	7.36%	4.3	39.4%		
ABS-Franchise	30,228	30,421	(22,047)	8,374	2,352	(763)	9,963	13	CCC	3.76%	25.49%	2.8	15.1%		
FNMA/FHLMC	3,140	3,358	-	3,358	56	-	3,414	1	AAA	5.70%	3.79%	3.2	N/A		
CDO	123,126	14,877	(14,877)	-	-	-	-	8	C	2.82%	0.00%	-	N/A		
Debt Security Total/Average	\$2,833,375	2,488,472	(699,730)	1,788,742	210,646	(143,086)	1,856,302	418	BB-	4.80%	9.15%	3.3			
Equity Securities	1,388	(276)		1,112	3,170	-	4,282	2							
Total	\$2,489,860	\$ (700,006)	\$1,789,854	\$213,816	\$ (143,086)	\$1,860,584	420								

(A) Represents the cumulative impairment against amortized cost basis recorded through earnings, net of the effect of the cumulative adjustment as a result of the adoption of new accounting guidance on impairment in 2009.

(B) See Note 7 regarding the estimation of fair value, which is equal to carrying value for all securities.

(C) Represents the weighted average of the ratings of all securities in each asset type, expressed as an S&P equivalent rating. For each security rated by multiple rating agencies, the lowest rating is used. Newcastle used an implied AAA rating for the FNMA/FHLMC securities. Ratings provided were determined by third party rating agencies as of a particular date, may not be current and are subject to change at any time.

(D) The weighted average maturity is based on the timing of expected principal reduction on the assets.

(E) Percentage of the outstanding face amount of securities and residual interests that is subordinate to Newcastle's investments.

(F) Includes the retained bonds with a face amount of \$4.0 million and a carrying value of \$1.2 million from Securitization Trust 2006 (Note 5). The residual interests were fully written off in the first quarter of 2010.

(G) Includes two CDO bonds issued by a third party with a carrying value of \$49.3 million, four CDO bonds issued by CDO V (which has been deconsolidated and held as an investment by Newcastle) with a carrying value of \$3.9 million and seven CDO bonds issued by C-BASS with a carrying value of \$2.8 million.

(H) As of December 31, 2011 and 2010, the total outstanding face amount of fixed rate securities was \$1.7 billion and \$2.1 billion, respectively, and of floating rate securities was \$733.5 million and \$728.1 million, respectively.

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Unrealized losses that are considered other-than-temporary are recognized currently in earnings. During the years ended December 31, 2011, 2010 and 2009, Newcastle recorded other-than-temporary impairment charges (“OTTI”) of \$12.9 million, \$101.4 million and \$603.8 million, respectively, with respect to real estate securities (gross of (\$2.9) million, \$2.4 million and \$70.2 million of other-than-temporary impairment recognized (reversed) in Other Comprehensive Income in 2011, 2010 and 2009, respectively). Based on management’s analysis of these securities, the performance of the underlying loans and changes in market factors, Newcastle noted adverse changes in the expected cash flows on certain of these securities and concluded that they were other-than-temporarily impaired. Any remaining unrealized losses as of each balance sheet date on Newcastle’s securities were primarily the result of changes in market factors, rather than issuer-specific credit impairment. Newcastle performed analyses in relation to such securities, using management’s best estimate of their cash flows, which support its belief that the carrying values of such securities were fully recoverable over their expected holding period. Such market factors include changes in market interest rates and credit spreads, or certain macroeconomic events, including market disruptions and supply changes, which did not directly impact our ability to collect amounts contractually due. Management continually evaluates the credit status of each of Newcastle’s securities and the collateral supporting those securities. This evaluation includes a review of the credit of the issuer of the security (if applicable), the credit rating of the security, the key terms of the security (including credit support), debt service coverage and loan to value ratios, the performance of the pool of underlying loans and the estimated value of the collateral supporting such loans, including the effect of local, industry and broader economic trends and factors. These factors include loan default expectations and loss severities, which are analyzed in connection with a particular security’s credit support, as well as prepayment rates. The result of this evaluation is considered when determining management’s estimate of cash flows and in relation to the amount of the unrealized loss and the period elapsed since it was incurred. Significant judgment is required in this analysis. The following table summarizes Newcastle’s securities in an unrealized loss position as of December 31, 2011.

Securities in an Unrealized Loss Position	Outstanding Face Amount	Amortized Cost Basis			Gross Unrealized			Number of Securities	Weighted Average			Maturity (Years)
		Before Impairment	Other-than-Temporary Impairment	After Impairment	Gains	Losses	Carrying Value		Rating	Coupon	Yield	
Less Than Twelve Months	\$ 679,084	\$ 581,333	\$ (18,809)	\$ 562,524	\$ -	\$ (57,312)	\$ 505,212	67	BBB-	4.55%	8.54%	4.5
Twelve or More Months	464,717	456,156	(2,258)	453,898	-	(63,363)	390,535	83	BB+	4.94%	5.54%	3.3
<b>Total</b>	<b>\$ 1,143,801</b>	<b>\$ 1,037,489</b>	<b>\$ (21,067)</b>	<b>\$ 1,016,422</b>	<b>\$ -</b>	<b>\$ (120,675)</b>	<b>\$ 895,747</b>	<b>150</b>	<b>BB+</b>	<b>4.71%</b>	<b>7.20%</b>	<b>4.0</b>

Newcastle performed an assessment of all of its debt securities that are in an unrealized loss position (unrealized loss position exists when a security’s amortized cost basis, excluding the effect of OTTI, exceeds its fair value) and determined the following:

	December 31, 2011			
	Amortized Cost Basis		Unrealized Losses	
	Fair Value	After Impairment	Credit (B)	Non-Credit (C)
Securities Newcastle intends to sell	\$ 6,332	\$ 6,332	\$ (773)	N/A
Securities Newcastle is more likely than not to be required to sell (A)	-	-	-	N/A
Securities Newcastle has no intent to sell and is not more likely than not to be required to sell:				
Credit impaired securities	24,039	27,341	(20,207)	(3,302)
Non credit impaired securities	871,708	989,081	-	(117,373)
<b>Total debt securities in an unrealized loss position</b>	<b>\$ 902,079</b>	<b>\$ 1,022,754</b>	<b>\$ (20,980)</b>	<b>\$ (120,675)</b>

- (A) Newcastle may, at times, be more likely than not to be required to sell certain securities for liquidity purposes. While the amount of the securities to be sold may be an estimate, and the securities to be sold have not yet been identified, Newcastle must make its best estimate, which is subject to significant judgment regarding future events, and may differ materially from actual future sales.
- (B) This amount is required to be recorded as other-than-temporary impairment through earnings. In measuring the portion of credit losses, Newcastle’s management estimates the expected cash flow for each of the securities. This evaluation includes a review of the credit status and the performance of the collateral supporting those securities, including the credit of the issuer, key terms of the securities and the effect of local, industry and broader economic trends. Significant inputs in estimating the cash flows include management’s expectations of prepayment speeds, default rates and loss severities. Credit losses are measured as the decline in the present value of the expected future cash flows discounted at the investment’s effective interest rate.
- (C) This amount represents unrealized losses on securities that are due to non-credit factors and is required to be recorded through other comprehensive income.

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As a result of new impairment guidance effective in 2009, Newcastle recorded a reclassification adjustment of \$1.3 billion of loss from Accumulated Deficit to Accumulated Other Comprehensive Income (Loss). This represents a substantive reversal of a large portion of an impairment charge recorded in the fourth quarter of 2008, which was originally recorded as a result of Newcastle's inability to express the intent and ability to hold its securities until an expected recovery in value (if any).

The following table summarizes the activity related to credit losses on debt securities:

	2011	2010
Beginning balance of credit losses on debt securities for which a portion of an OTTI was recognized in other comprehensive income	\$ (60,688)	\$ (408,782)
Additions for credit losses on securities for which an OTTI was not previously recognized	-	(12,156)
Increases to credit losses on securities for which an OTTI was previously recognized and a portion of an OTTI was recognized in other comprehensive income	(574)	(8,175)
Additions for credit losses on securities for which an OTTI was previously recognized without any portion of OTTI recognized in other comprehensive income	(16,269)	(25,520)
Reduction for credit losses on securities for which no OTTI was recognized in other comprehensive income at the current measurement date	12,998	228,871
Reduction for securities sold during the period	37,833	48,965
Reduction for securities deconsolidated during the period	6,254	112,408
Reduction for increases in cash flows expected to be collected that are recognized over the remaining life of the security	239	3,701
Ending balance of credit losses on debt securities for which a portion of an OTTI was recognized in other comprehensive income	<u>\$ (20,207)</u>	<u>\$ (60,688)</u>

The securities are encumbered by various debt obligations, as described in Note 8, at December 31, 2011.

As of December 31, 2011 and 2010, Newcastle had \$94.8 million and \$150.2 million of restricted cash, respectively, held in CDO financing structures pending its reinvestment in real estate securities and loans.

The table below summarizes the geographic distribution of the collateral securing our CMBS and ABS at December 31, 2011:

Geographic Location	CMBS		ABS	
	Outstanding Face Amount	Percentage	Outstanding Face Amount	Percentage
Western U.S.	\$ 609,732	39.4%	\$ 78,655	26.3%
Northeastern U.S.	260,057	16.8%	56,063	18.7%
Southeastern U.S.	298,564	19.3%	75,733	25.3%
Midwestern U.S.	172,510	11.2%	47,203	15.8%
Southwestern U.S.	132,484	8.6%	31,425	10.5%
Other	16,621	1.1%	10,282	3.4%
Foreign	55,909	3.6%	-	0.0%
	<u>\$ 1,545,877</u>	<u>100.0%</u>	<u>\$ 299,361</u>	<u>100.0%</u>

Geographic concentrations of investments expose Newcastle to the risk of economic downturns within the relevant regions, particularly given the current unfavorable market conditions. These market conditions may make regions more vulnerable to downturns in certain market factors. Any such downturn in a region where Newcastle holds significant investments could have a material, negative impact on Newcastle.

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**5. REAL ESTATE RELATED LOANS, RESIDENTIAL MORTGAGE LOANS, SUBPRIME MORTGAGE LOANS, CDO SERVICING RIGHTS AND INVESTMENTS IN EXCESS MORTGAGE SERVICING RIGHTS**

The following is a summary of real estate related loans, residential mortgage loans and subprime mortgage loans. The loans contain various terms, including fixed and floating rates, self-amortizing and interest only. They are generally subject to prepayment.

Loan Type	December 31, 2011										December 31, 2010	
	Outstanding Face Amount	Carrying Value (A)	Loan Count	Wtd. Avg. Yield	Weighted Average Coupon (B)	Weighted Average Maturity (Years) (B)	Rate Loans as a % of Face	Floating Rate Loans as a % of Face	Delinquent Amount (C)	Carrying Value	Wtd. Avg. Yield	
Mezzanine Loans	\$ 609,117	\$ 469,326	17	10.35%	7.35%	2.4	75.1%	\$ 12,000	\$ 388,510	13.48%		
Corporate Bank Loans	282,778	161,153	6	21.79%	9.27%	3.0	51.9%	-	208,365	15.63%		
B-Notes	174,153	152,535	5	12.25%	5.09%	2.8	65.5%	54,297	154,760	15.14%		
Whole Loans	30,566	30,566	3	5.31%	3.94%	1.9	95.3%	-	30,970	5.11%		
Total Real Estate Related Loans Held-for-Sale, Net (D)	\$ 1,096,614	\$ 813,580	31	12.78%	7.39%	2.6	68.1%	\$ 66,297	\$ 782,605	14.05%		
Non-Securitized Manufactured Housing Loan Portfolio I	\$ 768	\$ 199	22	39.80%	8.33%	0.7	0.0%	\$ 144	\$ 298	47.46%		
Non-Securitized Manufactured Housing Loan Portfolio II (E)	4,459	2,488	148	15.54%	10.27%	5.2	7.2%	950	203,053	8.30%		
Residential Loans	-	-	-	-	-	-	-	-	49,862	5.61%		
Total Residential Mortgage Loans Held-for-Sale, Net (G)	\$ 5,227	\$ 2,687	170	17.34%	9.98%	4.5	6.1%	\$ 1,094	\$ 253,213	7.81%		
Securitized Manufactured Housing Loan Portfolio I	\$ 135,209	\$ 112,316	3,555	9.51%	8.68%	7.5	1.0%	\$ 2,043	\$ 124,974	9.59%		
Securitized Manufactured Housing Loan Portfolio II	178,603	175,120	6,107	7.55%	9.64%	5.9	17.3%	2,715	-	-		
Residential Loans	60,156	43,800	213	7.92%	2.37%	6.7	100.0%	6,700	-	-		
Total Residential Mortgage Loans Held-for-Investment, Net (F) (G)	\$ 373,968	\$ 331,236	9,875	8.26%	8.12%	6.6	24.7%	\$ 11,458	\$ 124,974	9.59%		
Subprime Mortgage Loans Subject to Call Option	\$ 406,217	\$ 404,723							\$ 403,793			

(A) The aggregate United States federal income tax basis for such assets at December 31, 2011 was approximately \$1.4 billion, excluding the securitized subprime mortgage loans, which are fully consolidated for tax purposes. Carrying value includes interest receivable of \$0.1 million for the residential housing loans and principal and interest receivable of \$5.2 million for the manufactured housing loans.

(B) The weighted average maturity is based on the timing of expected principal reduction on the assets.

(C) Includes loans that are 60 days or more past due (including loans that are in foreclosure and borrowers' in bankruptcy) or considered real estate owned ("REO"). As of December 31, 2011 and December 31, 2010, \$117.2 million and \$158.8 million face amount of real estate related loans, respectively, was on non-accrual status.

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(D) Loans which are more than 3% of the total current carrying value (or \$24.4 million) at December 31, 2011 are as follows:

Loan Type	December 31, 2011							Weighted Average Maturity (Years)
	Outstanding Face Amount	Carrying Value	Prior Liens (1)	Loan Count	Yield (2)	Coupon (2)		
Individual Bank Loan (3)	\$ 136,156	\$ 106,156	701,931	1	24.85%	15.55%		3.36
Individual Mezzanine Loan (4)	70,000	70,000	425,000	1	8.52%	8.00%		1.58
Individual Mezzanine Loan (4)	70,000	70,000	735,000	1	8.69%	8.65%		4.42
Individual Mezzanine Loan (4)	53,510	52,382	815,728	1	12.50%	10.53%		2.50
Individual B-Note Loan (4)	50,000	50,000	225,000	1	6.32%	5.93%		4.25
Individual Mezzanine Loan (4)	45,000	45,000	317,000	1	9.25%	9.25%		1.92
Individual B-Note Loan (5)	54,298	44,524	2,087,317	1	15.89%	2.91%		1.69
Individual Mezzanine Loan (4)	40,000	40,000	324,940	1	8.24%	8.00%		2.17
Individual Mezzanine Loan (4)	39,958	38,160	672,942	1	8.45%	6.50%		4.25
Individual Mezzanine Loan (4)	38,510	37,290	815,728	1	15.00%	12.26%		2.50
Individual Whole Loan (6)	29,117	29,117	-	1	5.23%	3.76%		1.92
Individual B-Note (4)	36,423	29,077	53,116	1	15.00%	6.23%		3.06
Individual Mezzanine Loan (4)	26,119	26,119	621,654	1	7.72%	2.42%		0.08
Individual Mezzanine Loan (4)	25,000	25,000	369,940	1	10.51%	10.15%		2.17
Individual Mezzanine Loan (7)	55,574	24,801	199,420	1	15.00%	9.75%		3.33
Others (8)	326,949	125,954		16	14.49%	3.49%		2.11
	<u>\$ 1,096,614</u>	<u>\$ 813,580</u>		<u>31</u>	<u>12.78%</u>	<u>7.39%</u>		<u>2.60</u>

- (1) Represents face amount of third party liens that are senior to Newcastle's position.
- (2) For Others, represents weighted average yield and weighted average coupon.
- (3) Interest accrued to principal balance over life to maturity with a discounted payoff option prior to maturity.
- (4) Interest only payments over life to maturity and balloon principal payment upon maturity.
- (5) Defaulted.
- (6) Interest only payment over life to maturity with a discounted payoff option prior to loan maturity.
- (7) Interest accrued to principal balance over life to maturity.
- (8) Various terms of payment. This represents \$146.6 million, \$145.5 million, \$33.4 million and \$1.4 million face amounts of bank loans, mezzanine loans, B-notes and whole loans, respectively. Each of the sixteen loans had a carrying value of less than \$24.4 million at December 31, 2011.

(E) Includes securitized and non-securitized Manufactured Housing Loan Portfolio II at December 31, 2010.

(F) The following is an aging analysis of past due residential loans held-for-investment as of December 31, 2011:

	30-59 Days	60-89 Days	Over 90 Days	REO	Total Past		Total Outstanding Face Amount
	Past Due	Past Due	Past Due		Due	Current	
Securitized Manufactured Housing Loan Portfolio I	\$ 1,398	\$ 148	\$ 828	\$ 1,067	\$ 3,441	\$ 131,768	\$ 135,209
Securitized Manufactured Housing Loan Portfolio II	\$ 1,644	\$ 344	\$ 1,545	\$ 826	\$ 4,359	\$ 174,244	\$ 178,603
Residential Loans	\$ 1,080	\$ -	\$ 6,700	\$ -	\$ 7,780	\$ 52,376	\$ 60,156

Newcastle's management monitors the credit quality of the Manufactured Housing Loan Portfolios I and II primarily by using the aging analysis, current trends in delinquencies and the actual loss incurrence rate.

(G) Loans acquired at a discount for credit quality.

Newcastle's investments in real estate related loans and non-securitized manufactured housing loans were classified as held-for-sale as of December 31, 2011 and December 31, 2010. Loans held-for-sale are marked to the lower of carrying value or fair value.

Newcastle's investment in the securitized manufactured housing loan portfolio I was classified as held-for-investment as of December 31, 2011 and December 31, 2010. Newcastle's investment in the manufactured housing loan portfolio II was classified as held-for-sale as of December 31, 2010. However, subsequent to the refinancing of a portion of the manufactured housing loan portfolio II in May 2011, Newcastle reclassified the securitized portion of the related pool of loans from held-for-sale to held-for-investment since the longer term financing provided Newcastle with the ability to hold these loans for the foreseeable future. In connection with the securitizations of the manufactured housing loan portfolios,

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Newcastle gave representations and warranties with respect to the manufactured housing loans sold to the securitization trusts. To the extent a breach of any such representations and warranties materially and adversely affects the value or enforceability of the related loans, Newcastle will be required to repurchase such loans from the respective securitization trusts.

Newcastle's investment in the residential loans was classified as held-for-investment as of December 31, 2011 and classified as held-for-sale as of December 31, 2010. In the third quarter of 2011, in light of its current capital and liquidity positions, Newcastle re-evaluated its intent and ability to hold its investment in residential loans and determined that it has the intent and ability to hold this investment to maturity and reclassified this investment as held-for-investment.

The following is a summary of real estate related loans by maturity at December 31, 2011:

Year of Maturity <sup>(1)</sup>	Outstanding		Number of Loans
	Face Amount	Carrying Value	
Delinquent <sup>(2)</sup>	\$ 66,297	\$ 44,524	2
2012	113,273	47,697	4
2013	29,340	19,907	3
2014	350,847	227,902	9
2015	220,395	179,053	6
2016	299,501	279,526	6
Thereafter	16,961	14,971	1
Total	<u>\$ 1,096,614</u>	<u>\$ 813,580</u>	<u>31</u>

(1) Based on the final extended maturity date of each loan investment as of December 31, 2011.

(2) Includes loans that are non-performing, in foreclosure, or under bankruptcy.

Activities relating to the carrying value of our real estate loans and residential mortgage loans are as follows:

	Held for Sale		Held for Investment
	Real Estate Related	Residential Mortgage	Residential Mortgage
	Loans	Loans	Loans
<b>December 31, 2008</b>	\$ 843,212	\$ 409,632	\$ -
Additional fundings	10,777	-	-
Principal paydowns (A)	(207,299)	(54,177)	-
Sales	(28,781)	-	-
Valuation (allowance) reversal on loans	(44,564)	29,557	-
Other	517	(1,365)	-
<b>December 31, 2009</b>	\$ 573,862	\$ 383,647	\$ -
Purchases / additional fundings	113,733	-	-
Interest accrued to principal balance	12,535	-	-
Principal paydowns	(136,078)	(34,781)	(10,916)
Sales	(51,225)	-	-
Transfer to held for investment	-	(135,942)	135,942
Transfer to other investments	(24,907)	-	-
Valuation (allowance) reversal on loans	299,620	41,227	(960)
Accretion of loan discount and other amortization	-	-	1,035
Deconsolidation of CDO VII	(5,453)	-	-
Other	518	(938)	(127)
<b>December 31, 2010</b>	\$ 782,605	\$ 253,213	\$ 124,974
Purchases / additional fundings	384,850	-	-
Interest accrued to principal balance	19,507	-	-
Principal paydowns	(270,767)	(8,818)	(30,514)
Sales	(125,141)	-	-
Transfer to held-for-investment	-	(238,721)	238,721
Valuation (allowance) reversal on loans	21,629	(2,864)	(3,602)
Accretion of loan discount and other amortization	(7)	-	2,371
Other	904	(123)	(714)
<b>December 31, 2011</b>	<u>\$ 813,580</u>	<u>\$ 2,687</u>	<u>\$ 331,236</u>

(A) Includes \$1.4 million carrying value of two bank loans converted to equity securities during the year ended December 31, 2009.

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The following is a rollforward of the related loss allowance:

	Held for Sale		Held for Investment
	Real Estate Related Loans	Residential Mortgage Loans	Residential Mortgage Loans (C)
<b>Balance at December 31, 2009</b>	\$ (822,409)	\$ (96,409)	\$ -
Charge-offs (A)	195,935	8,105	1,494
Deconsolidation of CDO VII	5,263	-	-
Transfer to held-for-investment	-	21,884	(21,884)
Valuation (allowance) reversal on loans	299,620	41,227	(960)
<b>Balance at December 31, 2010</b>	\$ (321,591)	\$ (25,193)	\$ (21,350)
Charge-offs (A)	71,945	4,232	5,802
Reclassified as accretable discount (B)	-	-	14,439
Transfer to held-for-investment	-	21,364	(21,364)
Valuation (allowance) reversal on loans	21,629	(2,864)	(3,602)
<b>Balance at December 31, 2011</b>	\$ (228,017)	\$ (2,461)	\$ (26,075)

(A) The charge-offs for real estate related loans represent six and nine loans which were written off, sold, restructured, or paid off at a discounted price during 2011 and 2010, respectively.

(B) Represents the accretable discount of the residential loans upon the reclassification from held-for-sale to held-for-investment, which will be recognized prospectively as an adjustment of the loans' yield over the expected life of the loans.

(C) The allowance for credit losses was determined based on the guidance for loans acquired with deteriorated credit quality.

The average carrying amount of Newcastle's real estate related loans was approximately \$795.3 million, \$670.7 million and \$668.4 million during 2011, 2010 and 2009, respectively, on which Newcastle earned approximately \$65.7 million, \$53.3 million and \$53.8 million of gross interest revenues, respectively.

The average carrying amount of Newcastle's residential mortgage loans was approximately \$354.9 million, \$388.1 million and \$380.2 million during 2011, 2010 and 2009, respectively, on which Newcastle earned approximately \$34.1 million, \$37.8 million and \$42.6 million of gross interest revenues, respectively.

The loans are encumbered by various debt obligations as described in Note 8.

***CDO Servicing Rights***

In February 2011, Newcastle, through one of its subsidiaries, purchased the management rights with respect to certain CBASS Investment Management LLC ("C-BASS") CDOs pursuant to a bankruptcy proceeding for \$2.2 million. As a result, Newcastle became the collateral manager of certain CDOs previously managed by C-BASS and will earn, on average, a 20 basis point annual senior management fee on a portion of the total collateral, which was \$1.3 billion at acquisition. Newcastle initially recorded the cost of acquiring the collateral management rights as a servicing asset and subsequently amortizes this asset in proportion to, and over the period of, estimated net servicing income. Servicing assets are assessed for impairment on a quarterly basis, with impairment recognized as a valuation allowance. Key economic assumptions used in measuring any potential impairment of the servicing assets include the prepayment speeds of the underlying loans, default rates, loss severities and discount rates. During the year ended December 31, 2011, Newcastle recorded \$0.3 million of servicing rights amortization and no servicing rights impairment. As of December 31, 2011, Newcastle's servicing asset had a carrying value of \$2.0 million recorded in Receivables and Other Assets.

***Investments in Excess Mortgage Servicing Rights***

On December 8, 2011, Newcastle entered into an agreement (the "MSR Agreement") with Nationstar Mortgage LLC ("Nationstar"), an affiliate of Newcastle's manager, to purchase excess MSRs from Nationstar. Nationstar acquired the mortgage servicing rights on a pool of agency residential mortgage loans with an outstanding principal balance of approximately \$9.9 billion (the "Portfolio") on September 30, 2011. Nationstar is entitled to receive an initial weighted average total mortgage servicing fee of 35 basis points (bps) on the performing unpaid principal balance, as well as any ancillary income from the Portfolio. Pursuant to the MSR Agreement, Nationstar performs all servicing functions and advancing functions related to the Portfolio for a base mortgage servicing fee of 6 bps. Therefore, the remainder, or excess mortgage servicing fees are initially equal to a weighted average of 29 bps. Newcastle acquired the right to receive 65% of the excess mortgage servicing fees on the Portfolio and, subject to certain limitations and pursuant to a loan replacement agreement (the "Recapture Agreement"), 65% of the excess mortgage servicing fees on any future mortgage loans originated by Nationstar, which represent refinancings of loans in the Portfolio (which loans then become part of the

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Portfolio) for \$43.7 million. Nationstar has invested, pari passu with Newcastle, in 35% of the excess mortgage servicing fees. Nationstar, as servicer, also retains the ancillary income, the servicing obligations and liabilities as the servicer. If Nationstar is terminated as the servicer, Newcastle’s right to receive its portion of the excess mortgage servicing fee is also terminated. To the extent that Nationstar is terminated as the servicer and receives a termination payment, Newcastle is entitled to a pro rata share, or 65%, of such termination payment.

The following is a summary of Newcastle’s excess MSR investments at December 31, 2011:

	December 31, 2011			Year Ended December 31, 2011	
	Amortized Cost Basis	Carrying Value (A)	Weighted Average Yield	Weighted Average Maturity (Years) (B)	Changes in Fair Value Recorded in Other Income (Loss)
Portfolio I	\$ 37,469	\$ 37,637	20.0%	4.5	\$ 168
Portfolio I - Recapture Agreement	6,135	6,334	20.0%	10.3	199
	<u>\$ 43,604</u>	<u>\$ 43,971</u>	<u>20.0%</u>	<u>6.0</u>	<u>\$ 367</u>

(A) Fair value.

(B) The weighted average maturity is based on the timing of expected return of investments.

***Securitization of Subprime Mortgage Loans***

Newcastle acquired and securitized two portfolios of subprime residential mortgage loans (“Subprime Portfolio I” and “Subprime Portfolio II”), through subsidiaries, as summarized in the table below. Both portfolios are being serviced by an affiliate of the Manager for a servicing fee equal to 0.50% per annum on their respective unpaid principal balances.

Both portfolios were securitized through special purpose entities (“Securitization Trust 2006” and (“Securitization Trust 2007”) which are not consolidated by Newcastle. Newcastle retained a portion of the notes issued by, and all of the equity of, both entities. Newcastle, as holder of the equity (or residual interest), has the option (a call option) to redeem the notes once the aggregate principal balance of Subprime Portfolio I or Subprime Portfolio II is equal to or less than 20% or 10%, respectively, of such balance at the date of the transfer. The transactions between Newcastle and each securitization trust qualified as sales for accounting purposes. However, the loans which are subject to a call option by Newcastle were not treated as being sold and are classified as “held for investment” subsequent to the completion of the securitizations. The loans subject to call option and the corresponding financing recognize interest income and expense based on the expected weighted average coupons of the loans subject to call option at the call date of 9.24% and 8.68% for Subprime Portfolios I and II, respectively. The call options are “out of the money,” meaning that the price Newcastle would have to pay to acquire such loans exceeds their fair value at this time, and there is no requirement to exercise such options.

In both transactions, the residual interests and the retained bonds are reported as real estate securities, available for sale. The retained loans subject to call option and corresponding financing are reported as separate line items on Newcastle’s balance sheet.

Newcastle has no obligation to repurchase any loans from either of its subprime securitizations. Therefore, it is expected that its exposure to loss is limited to the carrying amount of its retained interests in the securitization entities, as described above. A subsidiary of Newcastle gave limited representations and warranties with respect to Subprime Portfolio II and is required to pay the difference, if any, between the repurchase price of any loan in such portfolio and the price required to be paid by a third party originator for such loan. Such subsidiary, however, has no assets and does not have recourse to the general credit of Newcastle.

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	Subprime Portfolio	
	I	II
Date of acquisition	March 2006	March 2007
Original number of loans (approximate)	11,300	7,300
Predominant origination date of loans	2005	2006
Original face amount of purchase	\$1.5 billion	\$1.3 billion
Pre-securitization loan write-down	(\$4.1 million)	(\$5.8 million)
Gain on pre-securitization hedge	\$5.5 million	\$5.8 million
Gain on sale	Less than \$0.1 million	\$0.1 million
Securitization date	April 2006	July 2007
Face amount of loans at securitization	\$1.5 billion	\$1.1 billion
Face amount of notes sold by trust	\$1.4 billion	\$1.0 billion
Stated maturity of notes	March 2036	April 2037
Face amount of notes retained by Newcastle	\$37.6 million	\$38.8 million
Fair value of equity retained by Newcastle	\$62.4 million (A)	\$46.7 million (A)
Key assumptions in measuring such fair value (A):		
Weighted average life (years)	3.1	3.8
Expected credit losses	5.3%	8.0%
Weighted average constant prepayment rate	28.0%	30.1%
Discount rate	18.8%	22.5%

(A) As of the date of transfer.

The following table presents information on the retained interests in the securitizations of Subprime Portfolios I and II at December 31, 2011:

	Subprime Portfolio		
	I	II	Total
Total securitized loans (unpaid principal balance) (A)	\$ 476,525	\$ 619,793	\$ 1,096,318
Loans subject to call option (carrying value)	\$ 299,176	\$ 105,547	\$ 404,723
Retained interests (fair value) (B)	\$ 1,195	\$ -	\$ 1,195

(A) Average loan seasoning of 77 months and 59 months for Subprime Portfolios I and II, respectively, at December 31, 2011.

(B) The retained interests include retained bonds of the securitizations. Their fair value is estimated based on pricing models. Newcastle's residual interests were written off in 2010. The weighted average yield of the retained notes was 9.09% as of December 31, 2011.

The following table summarizes certain characteristics of the underlying subprime mortgage loans, and related financing, in the securitizations as of December 31, 2011 (unaudited, except stated otherwise):

	Subprime Portfolio	
	I	II
Loan unpaid principal balance (UPB) (A)	\$ 476,525	\$ 619,793
Weighted average coupon rate of loans	5.35%	4.74%
Delinquencies of 60 or more days (UPB) (B)	\$ 118,818	\$ 186,261
Net credit losses for year ended		
December 31, 2011	\$ 29,460	\$ 54,217
December 31, 2010	\$ 37,881	\$ 64,389
Cumulative net credit losses	\$ 192,869	\$ 221,853
Cumulative net credit losses as a % of original UPB	12.8%	20.4%
Percentage of ARM loans (C)	52.4%	65.0%
Percentage of loans with loan-to-value ratio >90%	10.7%	17.2%
Percentage of interest-only loans	22.3%	4.3%
Face amount of debt (A) (D)	\$ 472,525	\$ 619,793
Weighted average funding cost of debt (E)	0.66%	1.36%

(A) Audited.

(B) Delinquencies include loans 60 or more days past due, in foreclosure, under bankruptcy filing or real estate owned.

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- (C) ARM loans are adjustable-rate mortgage loans. An option ARM is an adjustable-rate mortgage that provides the borrower with an option to choose from several payment amounts each month for a specified period of the loan term. None of the loans in the subprime portfolios are option ARMs.
- (D) Excludes face amount of \$4.0 million of retained notes for Subprime Portfolio I at December 31, 2011.
- (E) Includes the effect of applicable hedges.

Cash flows related to the two securitizations were as follows:

	Suprime Portfolio	
	I	II
Net cash inflows from retained interests		
Year Ended December 31, 2011	\$ 29	\$ 77
Year Ended December 31, 2010	\$ 315	\$ 629
Year Ended December 31, 2009	\$ 878	\$ 1,461

**6. OPERATING REAL ESTATE, HELD FOR SALE**

Newcastle has committed to a plan, and is actively working, to sell all of its operating real estate. As a result, all of the real estate has been classified as held for sale at December 31, 2011 and 2010 and marked to the lower of cost or market value based on a discounted cash flow analysis. All of the related operations, including these losses, have been classified as discontinued operations for all periods presented.

The following table summarizes the financial information for the discontinued operations:

	Year Ended December 31,		
	2011	2010	2009
Rental income	\$ 2,035	\$ 2,135	\$ 2,106
	2,035	2,135	2,106
Expenses	1,357	1,910	1,916
	678	225	190
Impairment	(433)	(260)	(550)
Net gain on sale	61	-	-
Other income	-	27	42
Net income (loss)	\$ 306	\$ (8)	\$ (318)

No income tax related to discontinued operations was recorded for the years ended December 31, 2011, 2010 or 2009.

The following table sets forth certain information regarding the operating real estate portfolio as of December 31, 2011:

Type of Property	Location	Net Rentable Sq. Ft. (A)	Acquisition Date	Year Built/ Renovated (A)	Initial Cost	Costs Capitalized Subsequent to Acquisition	Occupancy (A)	Carrying Value
<b>Ohio Portfolio</b>								
Office Building	Beavercreek, OH	56,797	Mar 06	1986	\$ 2,673	\$ 390	84.0%	\$ 2,662
Office Building	Beavercreek, OH	29,916	Mar 06	1986	2,727	132	100.0%	2,527
Office Building	Beavercreek, OH	45,500	Mar 06	1986	2,624	383	100.0%	2,552
		<u>132,213</u>			<u>\$ 8,024</u>	<u>\$ 905</u>	<u>93.2%</u>	<u>\$ 7,741</u>

(A) Unaudited.

The aggregate United States federal income tax basis for Newcastle's operating real estate at December 31, 2011 was approximately \$7.2 million. The operating real estate portfolio was pledged as collateral in one of Newcastle's non-recourse financing structures at December 31, 2011.

**7. FAIR VALUE OF FINANCIAL INSTRUMENTS**

Fair value may be based upon broker quotations, counterparty quotations or pricing services quotations, which provide valuation estimates based upon reasonable market order indications or a good faith estimate thereof and are subject to significant variability based on market conditions, such as interest rates, credit spreads and market liquidity. A significant portion of Newcastle's loans, securities and debt obligations are currently not traded in active markets and therefore have little or no price transparency. As a result, Newcastle has estimated the fair value of these illiquid instruments based on internal pricing models rather than quotations. The determination of estimated cash flows used in pricing models is inherently subjective and imprecise. Changes in market conditions, as well as changes in the assumptions or methodology used to determine fair value, could result in a significant change to estimated fair values. It should be noted that minor changes in assumptions or estimation methodologies can have a material effect on these derived or estimated fair values, and that the fair values reflected below are indicative of the interest rate and credit spread environments as of December 31, 2011 and do not take into consideration the effects of subsequent changes in market or other factors.

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**Fair Value Summary Table**

The carrying values and estimated fair values of Newcastle's financial instruments at December 31, 2011 and 2010 were as follows:

	December 31, 2011				December 31, 2010			
	Principal Balance or Notional Amount	Carrying Value	Estimated Fair Value	Fair Value Method (A)	Weighted Average Yield/Funding Cost	Weighted Average Maturity (Years)	Carrying Value	Estimated Fair Value
<b>Assets</b>								
<b>Non-Recourse VIE Financing Structures (F)</b>								
<b>Financial instruments:</b>								
Real estate securities, available-for-sale*	\$ 2,005,275	\$ 1,479,214	\$ 1,479,214	Broker quotations, counterparty quotations, pricing services, pricing models	9.60%	4.4	\$ 1,859,984	\$ 1,859,984
Real estate related loans, held-for-sale, net	1,072,071	807,214	812,883	Broker quotations, counterparty quotations, pricing services, pricing models	12.72%	2.6	750,130	754,589
Residential mortgage loans, held-for-investment, net	373,968	331,236	330,277	Pricing models	8.26%	6.6	124,974	128,369
Residential mortgage loans, held-for-sale, net	-	-	-	Pricing models	N/A	N/A	252,915	252,915
Subprime mortgage loans subject to call option (B)	406,217	404,723	404,723	(B)	9.09%	(B)	403,793	403,793
Restricted cash*	105,040	105,040	105,040				157,005	157,005
Derivative assets, treated as hedges (C)(E)*	104,205	1,092	1,092	Counterparty quotations	N/A	(C)	4,537	4,537
Non-hedge derivative assets (D)(E)*	36,428	862	862	Counterparty quotations	N/A	(D)	2,530	2,530
Operating real estate, held-for-sale		7,741	7,741				8,776	8,776
Other investments		18,883	18,883				18,883	18,883
Receivables and other assets		23,319	23,319				29,206	29,206
		<u>\$ 3,179,324</u>	<u>\$ 3,184,034</u>				<u>\$ 3,612,733</u>	<u>\$ 3,620,587</u>
<b>Recourse Financing Structures and Unlevered Assets</b>								
<b>Financial instruments:</b>								
Real estate securities, available-for-sale*	\$ 415,861	\$ 252,530	\$ 252,530	Broker quotations, counterparty quotations, pricing services, pricing models	2.28%	2.9	\$ 600	\$ 600
Real estate related loans, held-for-sale, net	24,543	6,366	6,366	Broker quotations, counterparty quotations, pricing services, pricing models	20.00%	2.4	32,475	32,475
Residential mortgage loans, held-for-sale, net	5,227	2,687	2,687	Pricing models	17.34%	4.5	298	298
Investments in excess mortgage servicing rights at fair value* (H)	9,705,512	43,971	43,971	Pricing models	20.00%	6.0	-	-
Cash and cash equivalents*	157,356	157,356	157,356				33,524	33,524
Other investments		6,024	6,024				6,024	6,024
Receivables and other assets		3,541	3,541				1,457	1,457
		<u>\$ 472,475</u>	<u>\$ 472,475</u>				<u>\$ 74,378</u>	<u>\$ 74,378</u>

\*Measured at fair value on a recurring basis.

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	December 31, 2011					December 31, 2010		
	Principal Balance or Notional Amount	Carrying Value	Estimated Fair Value	Fair Value Method (A)	Weighted Average Yield/Funding Cost	Weighted Average Maturity (Years)	Carrying Value	Estimated Fair Value
<b>Liabilities</b>								
<b>Non-Recourse VIE Financing Structures (F) (G)</b>								
<b>Financial instruments:</b>								
CDO bonds payable	\$ 2,405,044	\$ 2,403,605	\$ 1,500,307	Pricing models	2.76%	3.7	\$ 3,010,868	\$ 1,845,419
Other bonds and notes payable	202,456	200,377	203,136	Broker quotations, pricing models	4.31%	3.5	261,165	248,416
Repurchase agreements	6,546	6,546	6,546	Market comparables	2.05%	0.5	14,049	14,049
Financing of subprime mortgage loans subject to call option (B)	406,217	404,723	404,723	(B)	9.09%	(B)	403,793	403,793
Interest rate swaps, treated as hedges (C)(E)*	848,434	90,025	90,025	Counterparty quotations	N/A	(C)	136,575	136,575
Non-hedge derivatives (D)(E)*	316,600	29,295	29,295	Counterparty quotations	N/A	(D)	40,286	40,286
Accrued expenses and other liabilities		16,112	16,112				8,445	8,445
			<u>\$ 3,150,683</u>				<u>\$ 3,875,181</u>	<u>\$ 2,696,983</u>
<b>Recourse Financing Structures and Other Liabilities (G)</b>								
<b>Financial instruments:</b>								
Repurchase agreements	\$ 233,194	\$ 233,194	\$ 233,194	Market comparables	0.45%	0.2	\$ 4,683	\$ 4,683
Junior subordinated notes payable	51,004	51,248	30,145	Pricing models	7.41%	23.3	51,253	34,817
Due to affiliates		1,659	1,659				1,419	1,419
Dividends payable, accrued expenses and other liabilities		22,926	22,926				2,160	2,160
			<u>\$ 309,027</u>				<u>\$ 59,515</u>	<u>\$ 43,079</u>

(A) Methods are listed in order of priority. In the case of real estate securities and real estate related loans, broker quotations are obtained if available and practicable, otherwise counterparty quotations or pricing service valuations are obtained or, finally, internal pricing models are used. Internal pricing models are only used for (i) securities and loans that are not traded in an active market, and, therefore, have little or no price transparency, and for which significant unobservable inputs must be used in estimating fair value, or (ii) loans or debt obligations which are private and untraded.

(B) These two items result from an option, not an obligation, to repurchase loans from Newcastle's subprime mortgage loan securitizations (Note 5), are noneconomic until such option is exercised, and are equal and offsetting.

Notes continued on next page.

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(C) Represents derivative agreements as follows:

Year of Maturity	Weighted Average Month of Maturity	Aggregate Notional Amount	Weighted Average Fixed Pay Rate / Cap Rate	Aggregate Fair Value Asset / (Liability)
Interest rate cap agreements which receive 1-Month LIBOR above the cap rates:				
2015	Sep	\$ 21,000	2.26%	\$ 149
2016	Jul	77,905	2.66%	858
2017	Jan	5,300	1.86%	85
		<u>\$ 104,205</u>		<u>\$ 1,092</u>
Interest rate swap agreements which receive 1-Month LIBOR:				
2014	Nov	\$ 15,172	5.08%	(1,849)
2015	May	484,932	5.43%	(29,404)
2016	May	174,296	5.04%	(21,102)
2017	Aug	174,034	5.24%	(37,670)
		<u>\$ 848,434</u>		<u>\$ (90,025)</u>

- (D) This represents two interest rate swap agreements with a notional balance of \$127.7 million and \$188.9 million, maturing in March 2014 and March 2015, respectively, and three interest rate cap agreements with a total notional balance of \$36.4 million, maturing in August 2017 and January 2019. Newcastle entered into these hedge agreements to reduce its exposure to interest rate changes on the floating rate financings of its CDO IV, CDO VI and CDO X. These derivative agreements were not designated as hedges for accounting purposes as of December 31, 2011.
- (E) Newcastle's derivatives fall into two categories. As of December 31, 2011, all derivatives were held within Newcastle's nonrecourse CDO structures. An aggregate notional balance of \$1.2 billion, which were liabilities at period end, are only subject to the credit risks of the respective CDO structures. As they are senior to all the debt obligations of the respective CDOs and the fair value of each of the CDOs' total investments exceeded the fair value of each of the CDOs' derivative liabilities, no credit valuation adjustments were recorded. An aggregate notional balance of \$140.6 million were assets at period end and therefore are subject to the counterparty's credit risk. No adjustments have been made to the fair value quotations received related to credit risk as a result of the counterparty's "AA" credit rating. Newcastle's significant derivative counterparties include Bank of America, Credit Suisse, and Wells Fargo.
- (F) Assets held within CDOs and other non-recourse structures are not available to satisfy obligations outside of such financings, except to the extent Newcastle receives net cash flow distributions from such structures. Furthermore, creditors or beneficial interest holders of these structures have no recourse to the general credit of Newcastle. Therefore, Newcastle's exposure to the economic losses from such structures is limited to its invested equity in them and economically their book value cannot be less than zero. As a result, the fair value of Newcastle's net investments in these non-recourse financing structures is equal to the present value of their expected future net cash flows.
- (G) Newcastle notes that the unrealized gain on the liabilities within such structures cannot be fully realized.
- (H) The notional amount represents the total unpaid principal balance of the mortgage loans on which Newcastle is entitled to receive 65% of the excess MSRs on performing loans.

**Valuation Hierarchy**

The methodologies used for valuing such instruments have been categorized into three broad levels, which form a hierarchy.

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

Level 2 - Valuations based principally on other observable market parameters, including

- Quoted prices in active markets for similar instruments,
- Quoted prices in less active or inactive markets for identical or similar instruments,
- Other observable inputs (such as interest rates, yield curves, volatilities, prepayment speeds, loss severities, credit risks and default rates), and
- Market corroborated inputs (derived principally from or corroborated by observable market data).

Level 3 - Valuations based significantly on unobservable inputs.

- Level 3A - Valuations based on third party indications (broker quotes, counterparty quotes or pricing services) which were, in turn, based significantly on unobservable inputs or were otherwise not supportable as Level 2 valuations.
- Level 3B - Valuations based on internal models with significant unobservable inputs.

Newcastle follows this hierarchy for its financial instruments measured at fair value on a recurring basis. The classifications are based on the lowest level of input that is significant to the fair value measurement.

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The following table summarizes financial assets and liabilities measured at fair value on a recurring basis at December 31, 2011:

	Principal Balance or Notional Amount      Carrying Value		Fair Value			
			Level 2	Level 3A (1)	Level 3B (2)	Total
<b>Assets:</b>						
Real estate securities, available for sale:						
CMBS	\$ 1,545,877	\$ 1,128,818	\$ -	\$ 948,718	\$ 180,100	\$ 1,128,818
REIT debt	137,393	135,296	135,296	-	-	135,296
ABS - subprime	246,014	128,622	-	66,141	62,481	128,622
ABS - other real estate	53,347	38,107	-	31,188	6,919	38,107
FNMA / FHLMC	232,355	244,915	244,915	-	-	244,915
CDO	206,150	55,986	-	52,047	3,939	55,986
Real estate securities total	<u>\$ 2,421,136</u>	<u>1,731,744</u>	<u>380,211</u>	<u>1,098,094</u>	<u>253,439</u>	<u>1,731,744</u>
Investments in excess MSR(3)s	<u>\$ 9,705,512</u>	<u>\$ 43,971</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 43,971</u>	<u>\$ 43,971</u>
Derivative assets:						
Interest rate caps, treated as hedges	\$ 104,205	\$ 1,092	\$ 1,092	\$ -	\$ -	\$ 1,092
Interest rate caps, not treated as hedges	36,428	862	862	-	-	862
Derivative assets total	<u>\$ 140,633</u>	<u>\$ 1,954</u>	<u>\$ 1,954</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,954</u>
<b>Liabilities:</b>						
Derivative Liabilities:						
Interest rate swaps, treated as hedges	\$ 848,434	\$ 90,025	\$ 90,025	\$ -	\$ -	\$ 90,025
Interest rate swaps, not treated as hedges	316,600	29,295	29,295	-	-	29,295
Derivative liabilities total	<u>\$ 1,165,034</u>	<u>\$ 119,320</u>	<u>\$ 119,320</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 119,320</u>

(1) Third party pricing sources with significant unobservable inputs.

(2) Internal models with significant unobservable inputs.

(3) The notional amount represents the total unpaid principal balance of the mortgage loans on which Newcastle is entitled to receive 65% of the excess MSR(3)s on performing loans.

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Newcastle's investments in instruments (excluding the excess MSR investments, see below) measured at fair value on a recurring basis using Level 3 inputs changed as follows:

	Level 3A Assets					
	CMBS		ABS		Equity/Other	Total
	Conduit	Other	Subprime	Other	Securities	
Balance at January 1, 2010	\$ 536,092	\$ 397,407	\$ 87,883	\$ 46,059	\$ -	\$ 1,067,441
Transfers (A)						
Transfers from Level 3B	5,528	20,511	-	-	-	26,039
Transfers into Level 3B	(54,816)	(22,177)	(16,015)	-	-	(93,008)
CDO VII Deconsolidation	(32,858)	(3,379)	(10,685)	-	-	(46,922)
Total gains (losses) (B)						
Included in net income (loss) (C)	17,645	3,508	59	(345)	-	20,867
Included in other comprehensive income (loss)	198,146	79,436	1,455	7,354	-	286,391
Amortization included in interest income	16,663	7,131	7,515	179	-	31,488
Purchases, sales and settlements						
Purchases	279,095	34,478	44,894	-	-	358,467
Proceeds from sales	(88,645)	(49,260)	(6,478)	(11,525)	-	(155,908)
Proceeds from repayments	(36,623)	(135,751)	(25,046)	(5,529)	-	(202,949)
Balance at December 31, 2010	\$ 840,227	\$ 331,904	\$ 83,582	\$ 36,193	\$ -	\$ 1,291,906

	Level 3B Assets					
	CMBS		ABS		Equity/Other	Total
	Conduit	Other	Subprime	Other	Securities	
Balance at January 1, 2010	\$ 95,376	\$ 32,744	\$ 85,377	\$ 10,719	\$ 2,620	\$ 226,836
Transfers (A)						
Transfers from Level 3A	54,816	22,177	16,015	-	-	93,008
Transfers into Level 3A	(5,528)	(20,511)	-	-	-	(26,039)
CDO VII Deconsolidation	(48,665)	-	(17,890)	(457)	-	(67,012)
Total gains (losses) (B)						
Included in net income (loss) (C)	(83,128)	26,959	(9,374)	(3,488)	(422)	(69,453)
Included in other comprehensive income (loss)	107,272	55,781	31,469	4,163	1,938	200,623
Amortization included in interest income	17,204	1,207	11,843	483	-	30,737
Purchases, sales and settlements						
Purchases	-	14,414	-	-	146	14,560
Proceeds from sales	(2,066)	(21,646)	(1,063)	-	-	(24,775)
Proceeds from repayments	(27,824)	(89,979)	(21,953)	(2,435)	-	(142,191)
Balance at December 31, 2010	\$ 107,457	\$ 21,146	\$ 94,424	\$ 8,985	\$ 4,282	\$ 236,294

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	Level 3A Assets					
	CMBS		ABS		Equity/Other	Total
	Conduit	Other	Subprime	Other	Securities	
Balance at January 1, 2011	\$ 840,227	\$ 331,904	\$ 83,582	\$ 36,193	\$ -	\$ 1,291,906
Transfers (A)						
Transfers from Level 3B	41,158	25,000	19,950	718	2,641	89,467
Transfers into Level 3B	(88,464)	(24,826)	(15,031)	(7,548)	(2,475)	(138,344)
CDO V Deconsolidation	(59,970)	(55,838)	(5,107)	-	-	(120,915)
Total gains (losses) (B)						
Included in net income (loss) (C)	42,597	579	(23)	(113)	-	43,040
Included in other comprehensive income (loss)	(106,500)	38,583	(9,158)	(716)	(11,461)	(89,252)
Amortization included in interest income	23,878	5,883	5,210	338	3,376	38,685
Purchases, sales and settlements						
Purchases	313,857	27,262	29,359	7,548	69,308	447,334
Proceeds from sales	(139,387)	(54,885)	(6,573)	-	-	(200,845)
Proceeds from repayments	(51,113)	(161,227)	(36,068)	(5,232)	(9,342)	(262,982)
Balance at December 31, 2011	\$ 816,283	\$ 132,435	\$ 66,141	\$ 31,188	\$ 52,047	\$ 1,098,094

	Level 3B Assets					
	CMBS		ABS		Equity/Other	Total
	Conduit	Other	Subprime	Other	Securities	
Balance at January 1, 2011	\$ 107,457	\$ 21,146	\$ 94,424	\$ 8,985	\$ 4,282	\$ 236,294
Transfers (A)						
Transfers from Level 3A	88,464	24,826	15,031	7,548	2,475	138,344
Transfers into Level 3A	(41,158)	(25,000)	(19,950)	(718)	(2,641)	(89,467)
CDO V Deconsolidation	(32,289)	(1,908)	(14,568)	(3,833)	-	(52,598)
Total gains (losses) (B)						
Included in net income (loss) (C)	7,972	722	(1,332)	(287)	2,273	9,348
Included in other comprehensive income (loss)	32,374	1,743	3,766	(3,200)	(3,346)	31,337
Amortization included in interest income	17,055	163	8,796	911	617	27,542
Purchases, sales and settlements						
Purchases	13,634	25,000	25	-	10,192	48,851
Proceeds from sales	(27,400)	(721)	(8,624)	(348)	(3,884)	(40,977)
Proceeds from repayments	(25,487)	(6,493)	(15,087)	(2,139)	(6,029)	(55,235)
Balance at December 31, 2011	\$ 140,622	\$ 39,478	\$ 62,481	\$ 6,919	\$ 3,939	\$ 253,439

- (A) Transfers are assumed to occur at the beginning of the quarter. CDO V was deconsolidated on June 17, 2011 and CDO VII was deconsolidated on January 1, 2010.
- (B) None of the gains (losses) recorded in earnings during the periods is attributable to the change in unrealized gains (losses) relating to Level 3 assets still held at the reporting dates.
- (C) These gains (losses) are recorded in the following line items in the consolidated statements of operations:

	Year Ended December 31,			
	2011		2010	
	Level 3A	Level 3B	Level 3A	Level 3B
Gain (loss) on settlement of investments, net	\$ 44,560	\$ 22,895	\$ 23,775	\$ 26,668
Other income (loss), net	-	-	-	-
OTTI	(1,520)	(13,547)	(2,908)	(96,121)
Total	\$ 43,040	\$ 9,348	\$ 20,867	\$ (69,453)
Gain (loss) on sale of investments, net, from investments transferred into Level 3 during the period	\$ -	\$ -	\$ -	\$ -

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**Securities Valuation**

As of December 31, 2011, Newcastle’s securities valuation methodology and results are further detailed as follows:

Asset Type	Outstanding Face Amount (A)	Amortized Cost Basis (B)	Fair Value			Total
			Multiple Quotes (C)	Single Quote (D)	Internal Pricing Models (E)	
CMBS	\$ 1,545,877	\$ 1,124,447	\$ 745,189	\$ 203,529	\$ 180,100	\$ 1,128,818
REIT debt	137,393	135,931	34,029	101,267	-	135,296
ABS - subprime	246,014	123,022	46,715	19,426	62,481	128,622
ABS - other real estate	53,347	39,919	30,553	635	6,919	38,107
FNMA / FHLMC	232,355	243,385	153,062	91,853	-	244,915
CDO	206,150	67,625	2,750	49,297	3,939	55,986
<b>Total</b>	<b>\$ 2,421,136</b>	<b>\$ 1,734,329</b>	<b>\$ 1,012,298</b>	<b>\$ 466,007</b>	<b>\$ 253,439</b>	<b>\$ 1,731,744</b>

(A) Net of incurred losses.

(B) Net of discounts (or gross premiums) and after OTTI, including impairment taken during the period ended December 31, 2011.

(C) Management generally obtained pricing service quotations or broker quotations from two sources, one of which was generally the seller (the party that sold us the security). Management selected one of the quotes received as being most representative of fair value and did not use an average of the quotes. Even if Newcastle receives two or more quotes on a particular security that come from non-selling brokers or pricing services, it does not use an average because management believes using an actual quote more closely represents a transactable price for the security than an average level. Furthermore, in some cases there is a wide disparity between the quotes Newcastle receives. Management believes using an average of the quotes in these cases would generally not represent the fair value of the asset. Based on Newcastle’s own fair value analysis using internal models, management selects one of the quotes which is believed to more accurately reflect fair value. Newcastle never adjusts quotes received. These quotations are generally received via email and contain disclaimers which state that they are “indicative” and not “actionable” – meaning that the party giving the quotation is not bound to actually purchase the security at the quoted price.

(D) Management was unable to obtain quotations from more than one source on these securities. The one source was generally the seller (the party that sold us the security) or a pricing service.

(E) Securities whose fair value was estimated based on internal pricing models are further detailed as follows:

Asset Type	Amortized Cost Basis (B)	Fair Value	Impairment Recorded in Current Year	Unrealized Gains (Losses) in Accumulated OCI	Assumption Ranges			
					Discount Rate	Prepayment Speed (F)	Cumulative Default Rate	Loss Severity
CMBS - conduit	\$ 114,493	\$ 140,622	\$ 5,709	\$ 26,129	12.0%	N/A	0% - 100%	0% - 100%
CMBS - Large loan / single borrower	40,246	39,478	-	(768)	3% - 9%	N/A	0% - 100%	0% - 100%
ABS - subprime	49,859	62,481	2,624	12,622	8.0%	0% - 8%	25% - 87%	60% - 100%
ABS - other real estate	8,709	6,919	275	(1,790)	8.0%	1% - 5%	33% - 63%	85% - 95%
CDO	4,224	3,939	-	(285)	14.0%	4%	18%	83%
<b>Total</b>	<b>\$ 217,531</b>	<b>\$ 253,439</b>	<b>\$ 8,608</b>	<b>\$ 35,908</b>				

All of the assumptions listed have some degree of market observability, based on Newcastle’s knowledge of the market, relationships with market participants, and use of common market data sources. Collateral prepayment, default and loss severity projections are in the form of “curves” or “vectors” that vary for each monthly collateral cash flow projection. Methods used to develop these projections vary by asset class (e.g., CMBS projections are developed differently than Home Equity ABS projections) but conform to industry conventions. Newcastle uses assumptions that generate its best estimate of future cash flows of each respective security.

The prepayment vector specifies the percentage of the collateral balance that is expected to voluntarily pay off at each point in the future. The prepayment vector is based on projections from a widely published investment bank model, which considers factors such as collateral FICO score, loan-to-value ratio, debt-to-income ratio, and vintage on a loan level basis. This vector is scaled up or down to match recent collateral-specific prepayment experience, as obtained from remittance reports and market data services.

Loss severities are based on recent collateral-specific experience with additional consideration given to collateral characteristics. Collateral age is taken into consideration because severities tend to initially increase with collateral age before eventually stabilizing. Newcastle typically uses projected severities that are higher than the historic experience for collateral that is relatively new to account for this effect. Collateral characteristics such as loan size, lien position, and location (state) also effect loss severity. Newcastle considers whether a collateral pool has experienced a significant change in its composition with respect to these factors when assigning severity projections.

Default vectors are determined from the current “pipeline” of loans that are more than 90 days delinquent, in foreclosure, or are real estate owned (REO). These significantly delinquent loans determine the first 24 months of the default vector. Beyond month 24, the default vector transitions to a steady-state value that is generally equal to or greater than that given by the widely published investment bank model.

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The discount rates Newcastle uses are derived from a range of observable pricing on securities backed by similar collateral and offered in a live market. As the markets in which Newcastle transacts have become less liquid, Newcastle has had to rely on fewer data points in this analysis.

(F) Projected annualized average prepayment rate.

**Loan Valuation**

Loans which Newcastle does not have the ability or intent to hold into the foreseeable future are classified as held-for-sale. As a result, these held-for-sale loans are carried at the lower of amortized cost or fair value and are therefore recorded at fair value on a non-recurring basis. During the year ended December 31, 2011, Newcastle recorded (\$19.1) million and \$6.5 million of valuation allowance (reversal) on real estate related loans and residential mortgage loans (Note 5), respectively. These loans were written down to fair value at the time of the impairment, based on broker quotations, pricing service quotations or internal pricing models. All the loans were within Level 3 of the fair value hierarchy. For real estate related loans, the most significant inputs used in the valuations are the amount and timing of expected future cash flows, market yields and the estimated collateral value of such loan investments. For residential mortgage loans, significant inputs include management's expectations of prepayment speeds, default rates, loss severities and discount rates that market participants would use in determining the fair values of similar pools of residential mortgage loans.

The following tables summarize certain information for real estate related loans and residential mortgage loans held-for-sale as of December 31, 2011:

Loan Type	Outstanding			Valuation Allowance/ (Reversal) In Current Year	Significant Input Ranges	
	Face Amount	Carrying Value	Fair Value		Discount Rate	Loss Severity
Mezzanine	\$ 609,117	\$ 469,326	\$ 474,980	\$ (31,236)	7.7% - 20.0%	0.0% - 100.0%
Bank Loan	282,778	161,153	161,153	21,276	14.4% - 24.9%	0.0% - 74.0%
B-Note	174,153	152,535	152,535	(11,669)	6.3% - 15.9%	0.0%
Whole Loan	30,566	30,566	30,581	-	5.2% - 7.1%	0.0% - 15.0%
Total Real Estate Related Loans Held for Sale, Net	<u>\$ 1,096,614</u>	<u>\$ 813,580</u>	<u>\$ 819,249</u>	<u>\$ (21,629)</u>		

Loan Type	Outstanding			Valuation Allowance/ (Reversal) In Current Year	Significant Input Ranges			
	Face Amount	Carrying Value	Fair Value		Discount Rate	Prepayment Speed	Cumulative Default Rate	Loss Severity
Non-securitized Manufactured Housing Loans I	\$ 768	\$ 199	\$ 199	\$ 74	39.8%	0.0%	52.9%	75.0%
Non-securitized Manufactured Housing Loans II	4,459	2,488	2,488	(958)	15.5%	5.0%	10.2%	80.0%
Total Residential Mortgage Loans Held for Sale, Net	<u>\$ 5,227</u>	<u>\$ 2,687</u>	<u>\$ 2,687</u>	<u>\$ (884)</u>				

Loans which Newcastle has the intent and ability to hold into the foreseeable future are classified as held-for-investment. Loans held-for-investment are carried at the aggregate unpaid principal balance adjusted for any unamortized premium or discount, deferred fees or expenses, an allowance for loan losses, charge-offs and write-downs for impaired loans.

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The following table summarizes certain information for residential mortgage loans held-for-investment as of December 31, 2011:

Loan Type	Outstanding Face Amount	Carrying Value	Fair Value	Valuation Allowance/ (Reversal) In Current Year	Significant Input Ranges			
					Discount Rate	Prepayment Speed	Constant Default Rate	Loss Severity
Securitized Manufactured Housing Loans I	\$ 135,209	\$ 112,316	\$ 113,929	\$ 700	9.5%	3.0%	4.0%	75.0%
Securitized Manufactured Housing Loans II	178,603	175,120	172,561	3,132	7.6%	5.0%	3.5%	80.0%
Residential Loans	60,156	43,800	43,787	3,518	4.7% - 8.2%	0.0% - 5.0%	0.0% - 3.0%	0.0% - 50.0%
Total Residential Mortgage Loans, Held-for-Investment, Net	\$ 373,968	\$ 331,236	\$ 330,277	\$ 7,350				

**Excess MSRs Valuation**

Fair value estimates of Newcastle’s excess MSRs investments were based on internal pricing models. Significant inputs used in the valuations included expectations of prepayment speeds, delinquencies, default rates and recapture rates of the underlying mortgage loans, and discount rates that market participants would use in determining the fair values of servicing assets on similar pools of residential mortgage loans. In addition, in valuing the excess MSRs investments, management considered the likelihood of Nationstar being removed as servicer, which likelihood is considered to be remote.

The following table summarizes certain information regarding the inputs used in valuing the excess MSRs investments as of December 31, 2011:

	Significant Input Ranges					
	Prepayment Speed (A)	Delinquency (B)	Constant Default Rate (C)	Recapture Rate (D)	Excess Mortgage Servicing Fee (E)	Discount Rate
Portfolio I	20.0%	10.0%	5.0%	35.0%	29 bps	20.0%
Portfolio I - Recapture Agreement	8.0%	10.0%	5.0%	35.0%	21 bps	20.0%

- (A) Projected annualized weighted average lifetime prepayment rate using a prepayment vector.
- (B) Percentage of mortgage loans in the pool that were 30 or more days past due at period end.
- (C) Projected annualized average default rate.
- (D) Percentage of voluntarily prepaid loans that are expected to be refinanced by Nationstar.
- (E) Weighted average mortgage servicing fees in excess of the base mortgage servicing fee.

All of the assumptions listed have some degree of market observability, based on Newcastle’s knowledge of the market, relationships with market participants, and use of common market data sources. Prepayment and default projections are in the form of “curves” or “vectors” that vary over the expected life of the pool. Newcastle uses assumptions that generate its best estimate of future cash flows for each excess MSRs investment.

The prepayment vector specifies the percentage of the collateral balance that is expected to voluntarily pay off at each point in the future. The prepayment vector is based on projections that consider factors such as the underlying borrower’s FICO score, loan-to-value ratio, debt-to-income ratio, vintage on a loan level basis, as well as the potential effect on loans eligible for the Home Affordable Refinance Program 2.0 (“HARP 2.0”). This vector is scaled up or down to match recent collateral-specific prepayment experience, as obtained from remittance reports, market data services and other market factors.

Delinquency rates and default rates are based on recent pool-specific experience with additional consideration given to the current “pipeline” of loans that are more than 90 days delinquent, in foreclosure, or are real estate owned (REO).

Recapture projections are based on recent actual average recapture rates experienced by Nationstar on similar GSE mortgage loan pools.

For existing mortgage pools, excess mortgage servicing fee projections are based on actual mortgage servicing fees. For loans that are yet to be refinanced by Nationstar, Newcastle considers the excess mortgage servicing fees on loans recently originated by Nationstar and generally assumes lower excess servicing fees than the historic experience.

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The discount rates Newcastle uses are derived from a range of observable pricing on mortgage servicing assets backed by similar collateral.

Newcastle's MSR investments measured at fair value on a recurring basis using Level 3B inputs changed during the period ended December 31, 2011 as follows:

	Level 3B		
	Portfolio I	Portfolio I - Recapture Agreement	Total
Balance at December 31, 2010	\$ -	\$ -	\$ -
Transfers (A)			
Transfers from Level 3	-	-	-
Transfers into Level 3	-	-	-
Total gains (losses)			
Included in net income (B)	168	199	367
Amortization included in interest income	1,260	-	1,260
Purchases, sales and settlements			
Purchases	37,607	6,135	43,742
Proceeds from sales	-	-	-
Proceeds from repayments	(1,398)	-	(1,398)
Balance at December 31, 2011	<u>\$ 37,637</u>	<u>\$ 6,334</u>	<u>\$ 43,971</u>

(A) Transfers are assumed to occur at the beginning of the quarter.

(B) The gains (losses) recorded in earnings during the period are attributable to the change in unrealized gains (losses) relating to Level 3 assets still held at the reporting dates. These gains(losses) are recorded in "Other Income (Loss)" in the consolidated statement of income.

**Derivatives**

Newcastle's derivative instruments are valued using counterparty quotations. These quotations are generally based on valuation models with model inputs that can generally be verified and which do not involve significant judgment. The significant observable inputs used in determining the fair value of our Level 2 derivative contracts are contractual cash flows and market based interest rate curves.

Newcastle's derivatives are recorded on its balance sheet as follows:

	Balance sheet location	Fair Value	
		2011	2010
<b>Derivative Assets</b>			
Interest rate caps, designated as hedges	Derivative Assets	\$ 1,092	\$ 4,537
Interest rate caps, not designated as hedges	Derivative Assets	862	2,530
		<u>\$ 1,954</u>	<u>\$ 7,067</u>
<b>Derivative Liabilities</b>			
Interest rate swaps, designated as hedges	Derivative Liabilities	\$ 90,025	\$ 136,575
Interest rate swaps, not designated as hedges	Derivative Liabilities	29,295	40,286
		<u>\$ 119,320</u>	<u>\$ 176,861</u>

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The following table summarizes information related to derivatives:

	December 31,	
	2011	2010
Cash flow hedges		
Notional amount of interest rate swap agreements	\$ 848,434	\$ 1,473,669
Notional amount of interest rate cap agreements	104,205	104,205
Amount of (loss) recognized in OCI on effective portion	(69,908)	(118,608)
Deferred hedge gain (loss) related to anticipated financings, which have subsequently occurred, net of amortization	299	357
Deferred hedge gain (loss) related to dedesignation, net of amortization	(893)	1,343
Expected reclassification of deferred hedges from AOCI into earnings over the next 12 months	1,688	2,289
Expected reclassification of current hedges from AOCI into earnings over the next 12 months	(35,348)	(63,541)
Non-hedge Derivatives		
Notional amount of interest rate swap agreements	316,600	343,570
Notional amount of interest rate cap agreements	36,428	36,428

The following table summarizes gains (losses) recorded in relation to derivatives:

	Income Statement Location	Year Ended December 31,		
		2011	2010	2009
Cash flow hedges				
Gain (loss) on the ineffective portion	Other Income (Loss) Gain (Loss) on Sale of Investments,	\$ (917)	\$ 580	\$ (278)
Gain (loss) immediately recognized at dedesignation	Other Income (Loss)	(13,939)	(39,184)	(15,223)
Amount of gain (loss) reclassified from AOCI into income, related to effective portion	Interest Expense	(63,350)	(83,869)	(100,046)
Deferred hedge gain reclassified from AOCI into income, related to anticipated financings	Interest Expense	58	475	101
Deferred hedge gain (loss) reclassified from AOCI into income, related to effective portion of dedesignated hedges	Interest Expense	2,259	(5,471)	(9,547)
Non-hedge derivatives gain (loss)	Other Income (Loss)	3,284	(1,240)	15,446

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**8. DEBT OBLIGATIONS**

The following table presents certain information regarding Newcastle's debt obligations and related hedges:

December 31, 2011

December 31, 2010

Debt Obligation/Collateral	Month Issued	Outstanding Face Amount	Carrying Value	Final Stated Maturity	Unhedged Weighted Average Funding Cost (A)	Weighted Average Funding Cost (B)	Weighted Average Maturity (Years)	Face Amount of Floating Rate Debt	Outstanding Face Amount (C)	Amortized Cost Basis (C)	Carrying Value (C)	Weighted Average Maturity (Years)	Floating Rate Face Amount (C)	Amount of Aggregate Notional Current Hedges (D)	Outstanding Face Amount	Carrying Value
<b>CDO Bonds Payable</b>																
CDO IV (E)	Mar 2004	\$ 106,645	\$ 106,454	Mar 2039	1.85%	4.90%	2.3	\$ 95,292	\$ 208,164	\$ 196,396	\$ 180,853	2.6	\$ 63,027	\$ 95,292	\$ 285,907	\$ 285,211
CDO V (F)	Sep 2004	N/A	N/A	Sep 2039	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	3,60,689	3,59,603
CDO VI (E)	Apr 2005	9,141	9,141	Apr 2040	0.94%	5.59%	3.3	88,253	246,967	127,304	151,326	3.7	58,546	88,253	90,717	90,717
CDO VIII	Nov 2006	577,133	575,736	Nov 2052	0.88%	2.16%	2.9	569,533	729,929	530,674	540,439	3.2	443,088	155,796	618,313	617,611
CDO IX	May 2007	480,125	482,329	May 2052	0.68%	0.68%	2.8	480,125	684,680	556,552	554,313	3.1	393,321	-	480,125	484,172
CDO X	Jul 2007	1,150,000	1,147,945	Jul 2052	0.65%	3.54%	4.6	1,150,000	1,257,084	942,487	933,084	4.8	187,662	833,271	1,175,000	1,173,554
		2,405,044	2,403,605			2.76%	3.7	2,383,203	3,126,824	2,353,413	2,360,015	3.8	1,145,644	1,172,612	3,010,751	3,010,868
<b>Other Bonds and Notes Payable</b>																
MH Loans Portfolio I (G)	Apr 2010	70,109	69,256	Jul 2035	5.42%	5.42%	3.1	-	135,209	112,316	112,316	7.5	1,320	-	86,352	85,071
MH Loans Portfolio II (G)	May 2011	126,856	125,630	Dec 2033	3.83%	3.83%	3.5	-	178,603	175,120	175,120	5.9	30,861	-	171,972	171,738
Residential Mortgage Loans (H)	Aug 2006	5,491	5,491	Dec 2034	LIBOR+0.90%	1.20%	7.0	5,491	56,377	40,380	40,380	6.9	56,377	-	4,356	4,356
		202,456	200,377			4.31%	3.5	5,491	370,189	327,816	327,816	6.6	88,558	-	262,680	261,165
<b>Repurchase Agreements</b>																
Real estate securities, loans and properties (I)	Dec 2011	8,728	8,728	Jun 2012	LIBOR+1.75%	2.05%	0.5	8,728	-	-	-	-	-	-	18,732	18,732
FNMA/FHLMC securities (I)	Various	23,1012	23,1012	Feb 2012	0.43%	0.43%	0.2	23,1012	232,355	244,916	244,916	4.6	232,355	N/A	N/A	N/A
		239,740	239,740			0.49%	0.2	239,740	232,355	244,916	244,916	4.6	232,355	-	18,732	18,732
<b>Corporate</b>																
Junior subordinated notes payable	Mar 2006	51,004	51,248	Apr 2035	7.57%(L)	7.41%	23.3	-	-	-	-	-	-	-	51,004	51,253
		51,004	51,248			7.41%	23.3	-	-	-	-	-	-	-	51,004	51,253
Subtotal debt obligations		2,898,244	2,894,970			2.76%	3.7	\$ 2,628,434	\$ 3,729,368	\$ 2,926,145	\$ 2,932,747	4.1	\$ 1,466,557	\$ 1,172,612	\$ 3,343,167	\$ 3,342,018
Financing on subprime mortgage loans subject to call option		406,217	404,723												403,793	403,793
Total debt obligations		\$ 3,304,461	\$ 3,299,693												\$ 3,746,960	\$ 3,745,811

(A) Weighted average, including floating and fixed rate classes and including the amortization of deferred financing costs.

(B) Including the effect of applicable hedges.

(C) Including restricted cash available for reinvestment in CDOs.

(D) Including a \$36.4 million notional amount of interest rate cap agreements in CDO X, and \$95.3 million and \$88.3 million of interest rate swap agreements in CDOs IV and VI, respectively, which were economic hedges not designated as hedges for accounting purposes.

(E) These CDOs were not in compliance with their applicable over collateralization tests as of December 31, 2011. Newcastle is not receiving cash flows from these CDOs (other than senior management fees and cash flows on senior classes of bonds that were repurchased), since net interest is being used to pay debt, and expects these CDOs to remain out of compliance for the foreseeable future.

(F) Deconsolidated on June 17, 2011.

(G) Excluding \$36.9 million and \$17.0 million face amount of other bonds payable relating to MH loans Portfolio I and Portfolio II, respectively, and \$49.4 million face amount of notes payable relating to residential mortgage loans sold to certain Newcastle CDOs, which were eliminated in consolidation.

(H) Notes payable issued to CDO V, that are no longer eliminated since the deconsolidation of CDO V.

(I) The counterpart of this repurchase agreement is Bank of America. It is secured by \$29.1 million face amount of notes issued by Newcastle CDO VI, which is eliminated on consolidation. The maximum recourse to Newcastle is \$2.2 million.

(J) The counterparties on these repurchase agreements are Bank of America and Goldman Sachs. Interest rates on these repurchase agreements are fixed, but will be reset on a short-term basis.

(K) Issued in April 2006 and July 2007. See Note 5 regarding the securitizations of Subprime Portfolios I and II.

(L) LIBOR + 2.25% after April 2016.

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Certain of the debt obligations included above are obligations of consolidated subsidiaries of Newcastle which own the related collateral. In some cases, including the CDO and Other Bonds Payable, such collateral is not available to other creditors of Newcastle.

#### CDO Bonds Payable

Each CDO financing is subject to tests that measure the amount of over collateralization and excess interest in the transaction. Failure to satisfy these tests would cause the principal and/or interest cashflow that would otherwise be distributed to more junior classes of securities (including those held by Newcastle) to be redirected to pay down the most senior class of securities outstanding until the tests are satisfied. As a result, our cash flow and liquidity are negatively impacted upon such a failure. As of December 31, 2011, CDOs IV and VI were not in compliance with their applicable over collateralization tests.

During 2009, Newcastle repurchased \$246.7 million of CDO bonds for \$29.9 million and recorded a gain of \$215.3 million. During 2010, Newcastle repurchased \$483.7 million of CDO bonds for \$215.8 million and recorded a gain of \$265.7 million. During 2011, Newcastle repurchased \$167.5 million face amount of CDO bonds for \$102.0 million and recorded a gain of \$65.0 million.

In December 2010, Newcastle, together with one or more of its wholly owned subsidiaries, completed a series of transactions whereby it repurchased approximately \$257 million current principal balance of Newcastle CDO VI Class I-MM notes at a price of 67.5% of par. The purchased notes represent all of the outstanding Class I-MM notes of Newcastle CDO VI (the "notes"). Newcastle purchased the notes using a combination of restricted cash, unrestricted cash and proceeds from a new repurchase facility, entered into in connection with the purchase of a portion of the notes. The repurchase facility matures in June 2012 and bears interest at a rate of LIBOR + 1.75%. In accordance with GAAP, Newcastle recorded an \$82 million gain on the extinguishment of debt and \$24 million of mark-to-market loss on the related interest rate swap agreement. As of December 31, 2011, the repurchase agreement had an outstanding balance of \$8.7 million, which was secured by \$29.1 million current principal balance of the notes. Although the repurchase facility contains mark to market provisions that require margin to be posted in the event that the value of the notes decreases, the recourse to Newcastle is limited to twenty-five percent of the then-outstanding balance of the repurchase facility, which was approximately \$2.2 million as of December 31, 2011.

In late 2009, CDO VII failed additional over collateralization tests. The consequences of failing these tests are that an event of default has occurred and Newcastle may be removed as the collateral manager under the documentation governing CDO VII. As a result of this failure and upon the adoption of the new accounting guidance on consolidation, CDO VII was deconsolidated effective January 1, 2010.

In April 2011, Newcastle entered into an agreement to sell its retained interests in Newcastle CDO VII. Pursuant to the agreement, the buyer of the retained interests liquidated CDO VII in June 2011 and paid Newcastle total consideration of approximately \$3.9 million. As a result, Newcastle recorded a gain of approximately \$3.4 million in the second quarter of 2011, representing the excess of the sales proceeds over the carrying value of Newcastle's retained interests.

In June 2011, Newcastle deconsolidated a non-recourse financing structure, CDO V. Newcastle determined that it does not currently have the power to direct the relevant activities of CDO V as an event of default had occurred and Newcastle may be removed as the collateral manager by a single party. So long as the event of default continues, Newcastle will not be permitted to purchase or sell any collateral in CDO V. If Newcastle is removed as the collateral manager of CDO V, it would no longer receive the senior management fees from such CDO. As of February 29, 2012, Newcastle has not been removed as collateral manager. Newcastle does not expect the failure of these additional tests to have a material negative impact on its cash flows, business, results of operations or financial condition.

As of February 17, 2012, CDOs IV and VI were not in compliance with their applicable over collateralization tests and, consequently, Newcastle was not receiving cash flows from these CDOs currently (other than senior management fees and interest distributions from senior classes of bonds Newcastle owns). Based upon Newcastle's current calculations, Newcastle expects these two portfolios to remain out of compliance for the foreseeable future. Moreover, given current market conditions, it is possible that all of Newcastle's CDOs could be out of compliance with their over collateralization tests as of one or more measurement dates within the next twelve months.

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Other Bonds Payable

On April 15, 2010, Newcastle completed a securitization transaction to refinance its Manufactured Housing Loans Portfolio I (the "Portfolio"). Newcastle sold approximately \$164.1 million outstanding principal balance of manufactured housing loans to Newcastle MH I LLC (the "2010 Issuer"). The 2010 Issuer issued approximately \$134.5 million aggregate principal amount of asset-backed notes, of which \$97.6 million was sold to third parties and \$36.9 million was sold to certain CDOs managed and consolidated by Newcastle. At the closing of the securitization transaction, Newcastle used the gross proceeds received from the issuance of the Notes to repay the previously existing financing on this portfolio in full, terminate the related interest rate swap contracts, pay the related transaction costs and increase its unrestricted cash by approximately \$14 million. Under the applicable accounting guidance, the securitization transaction is accounted for as a secured borrowing. As a result, no gain or loss is recorded for the transaction. Newcastle continues to recognize the portfolio of manufactured housing loans as pledged assets, which have been classified as loans held for investment at securitization, and records the notes issued to third parties as a secured borrowing. The associated assets, liabilities, revenues and expenses are presented in the non-recourse financing structure sections of the consolidated financial statements.

On May 4, 2011, Newcastle completed a securitization transaction to refinance its Manufactured Housing Loans Portfolio II. Newcastle sold approximately \$197.0 million outstanding principal balance of manufactured housing loans to Newcastle Investment Trust 2011-MH I (the "2011 Issuer"), an indirect wholly-owned subsidiary of Newcastle. The 2011 Issuer issued approximately \$159.8 million aggregate principal amount of investment grade notes, of which \$142.8 million was sold to third parties and \$17.0 million was sold to one of the CDOs managed and consolidated by Newcastle. In addition, Newcastle retained the below investment grade notes and residual interest. As a result, Newcastle invested approximately \$20.0 million of its unrestricted cash in the new securitization structure. The notes issued to third parties have an average expected maturity of 3.8 years and bear interest at an average rate of 3.23% per annum. At the closing of the securitization transaction, Newcastle used the gross proceeds received from the issuance of the notes to repay the previously existing debt in full, terminate the related interest rate swap contracts and pay the related transaction costs. Under the applicable accounting guidance, the securitization transaction is accounted for as a secured borrowing. As a result, no gain or loss is recorded for the transaction. Newcastle continues to recognize the portfolio of manufactured housing loans as pledged assets, which have been classified as residential mortgage loans held-for-investment at securitization, and records the notes issued to third parties as a secured borrowing. The associated assets, liabilities, revenues and expenses are presented in the non-recourse financing structure sections of the consolidated financial statements.

Junior Subordinated Notes Payable

In March 2006, Newcastle completed the placement of \$100 million of trust preferred securities through its wholly owned subsidiary, Newcastle Trust I (the "Preferred Trust"). Newcastle owned all of the common stock of the Preferred Trust. The Preferred Trust used the proceeds to purchase \$100.1 million of Newcastle's junior subordinated notes. These notes represented all of the Preferred Trust's assets. The terms of the junior subordinated notes were substantially the same as the terms of the trust preferred securities.

On April 30, 2009, Newcastle entered into an exchange agreement with several collateralized debt obligations managed by a third party pursuant to which Newcastle agreed to exchange newly issued junior subordinated notes due in 2035 with an initial aggregate principal amount of \$101.7 million (the "Notes") for \$100 million in aggregate liquidation amount of trust preferred securities that were previously issued by a subsidiary of Newcastle (the "TRUPs") and were owned by the third party. The Notes accrued interest at a rate of 1.0% per year, beginning on February 1, 2009, and the rate reverted to 7.574% on February 1, 2010 in connection with the preferred stock exchange (Note 9). In conjunction with the exchange, the TRUPs were cancelled. Under the provisions of ASC 470-60, "Troubled Debt Restructurings by Debtors", this exchange was considered a troubled debt restructuring which required Newcastle to account for the effect of the interest modification prospectively and to record the expenses related to the modification immediately through earnings.

On January 29, 2010, Newcastle entered into an Exchange Agreement (the "Exchange Agreement") with Taberna Capital Management, LLC and certain of its affiliates (collectively, "Taberna"), pursuant to which Newcastle and Taberna agreed to exchange (the "Exchange") approximately \$52.1 million aggregate principal amount of junior subordinated notes due 2035 for approximately \$37.6 million face amount of previously issued CDO securities and approximately \$9.7 million of cash held by Newcastle. In other words, \$52.1 million face amount of Newcastle's debt, in the form of junior subordinated notes payable, was repurchased and extinguished for GAAP purposes in exchange for (i) the payment of \$9.7 million of cash and (ii) the reissuance of \$37.6 million face amount of CDO bonds payable (which had previously been repurchased by Newcastle). In connection with the Exchange, Newcastle paid or reimbursed \$0.6 million of expenses incurred by Taberna, various indenture trustees and their respective advisors in accordance with the terms of the Exchange Agreement.

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Newcastle accounted for this exchange as a troubled debt restructuring involving the partial repayment of debt. As a result, Newcastle recorded no gain or loss. The following table presents certain information regarding the exchange, as of the date of the exchange:

	Repurchased junior subordinated notes	Consideration		
		Cash	Reissued CDO bonds	Total
Outstanding face amount	\$ 52,094	\$ 9,715	\$ 37,625	\$ 47,340
Weighted average coupon	7.574% (A)	N/A	LIBOR + 0.66% (B)	
Maturity	April 2035		June 2052	
Collateral	General credit of Newcastle		Assets within the respective CDOs	

(A) LIBOR + 2.25% after April 2016

(B) Weighted average effective interest rate of approximately LIBOR+0.35% after the Exchange.

The fair value of the consideration paid approximated the fair value of the repurchased junior subordinated notes of \$16.7 million.

Maturity Table

Newcastle’s debt obligations (gross of \$4.8 million of discounts at December 31, 2011) have contractual maturities as follows:

	Nonrecourse	Recourse	Total
2012	\$ 6,546	\$ 233,194	\$ 239,740
2013	-	-	-
2014	-	-	-
2015	-	-	-
2016	-	-	-
Thereafter	3,013,717	51,004	3,064,721
Total	\$ 3,020,263	\$ 284,198	\$ 3,304,461

Debt Covenants

Newcastle’s non-CDO financings contain various customary loan covenants. Newcastle was in compliance with all of the covenants in its non-CDO financings as of February 29, 2012.

**9. EQUITY AND EARNINGS PER SHARE**

Earnings per Share

Newcastle is required to present both basic and diluted earnings per share (“EPS”). Basic EPS is calculated by dividing net income (loss) applicable to common stockholders by the weighted average number of shares of common stock outstanding during each period. Diluted EPS is calculated by dividing net income (loss) applicable to common stockholders by the weighted average number of shares of common stock outstanding plus the additional dilutive effect of common stock equivalents during each period. Newcastle’s common stock equivalents are its stock options. During 2011, based on the treasury stock method, Newcastle had 6,324 dilutive common stock equivalents, resulting from its outstanding options. During 2010 and 2009, Newcastle had no dilutive common stock equivalents (common stock equivalents are not dilutive in periods of net loss or when all of the exercise prices exceed the current market price). Net income (loss) applicable to common stockholders is equal to net income (loss) less preferred dividends, plus the excess of the carrying amount of exchanged preferred stock over the fair value of consideration paid (see “Preferred Stock” below).

In March 2011, Newcastle filed a shelf registration statement with the SEC covering common stock, preferred stock, depositary shares, debt securities and warrants.

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Option Plan

In June 2002, Newcastle (with the approval of the board of directors) adopted a nonqualified stock option and incentive award plan (the "Newcastle Option Plan") for officers, directors, consultants and advisors, including the Manager and its employees. The maximum available for issuance is equal to 10% of the number of outstanding equity interests of Newcastle, subject to a maximum of 10,000,000 shares in the aggregate over the term of the plan.

Upon joining the board, the non-employee directors have been, in accordance with the Newcastle Option Plan, automatically granted options to acquire an aggregate of 20,000 shares of common stock. The fair value of such options was not material at the date of grant.

Through December 31, 2011, for the purpose of compensating the Manager for its successful efforts in raising capital for Newcastle, the Manager has been granted options representing the right to acquire 7,836,227 shares of common stock, with strike prices subject to adjustment as necessary to preserve the value of such options in connection with the occurrence of certain events (including capital dividends and capital distributions made by Newcastle). These options represented an amount equal to 10% of the shares of common stock of Newcastle sold in its public offerings and the value of such options was recorded as an increase in stockholders' equity with an offsetting reduction of capital proceeds received. The options granted to the Manager, which may be assigned by Fortress to its employees, were fully vested on the date of grant and one thirtieth of the options become exercisable on the first day of each of the following thirty calendar months, or earlier upon the occurrence of certain events, such as a change in control of Newcastle or the termination of the Management Agreement. The options expire ten years from the date of issuance.

Newcastle's outstanding options were summarized as follows:

	December 31,	
	2011	2010
Held by the Manager	5,998,947	1,686,447
Issued to the Manager and subsequently transferred to certain of Fortress's employees	798,162	798,162
Issued to the independent directors	16,000	14,000
Total	<u>6,813,109</u>	<u>2,498,609</u>

The following table summarizes Newcastle's outstanding options at December 31, 2011. Note that the last sales price on the New York Stock Exchange for Newcastle's common stock in the year ended December 31, 2011 was \$4.65 per share.

Recipient	Date of Grant/Exercise	Number of Options	Options Exercisable at December 31, 2011	Weighted Average Exercise Price (A)	Fair Value At Grant Date (Millions) (B)	Intrinsic Value at December 31, 2011 (millions)
Directors	Various	20,000	16,000	\$15.78	Not Material	-
Manager (C)	2002	700,000	31,500	\$12.60	\$0.4	-
Manager (C)	2003	788,227	420,984	\$20.99	\$1.2	-
Manager (C)	2004	837,500	834,125	\$26.66	\$1.6	-
Manager (C)	2005	330,000	330,000	\$29.20	\$1.1	-
Manager (C)	2006	170,000	170,000	\$29.02	\$0.5	-
Manager (C)	2007	698,000	698,000	\$28.58	\$2.0	-
Manager (C)	Mar-11	1,725,000	517,500	\$6.00	\$7.0 (E)	-
Manager (C)	Sep-11	2,587,500	258,750	\$4.55	\$5.6 (F)	\$0.3
Exercised (D)	Prior to 2008	(1,043,118)	N/A	\$15.70	N/A	N/A
Outstanding		<u>6,813,109</u>	<u>3,276,859</u>	<u>\$13.02</u>		

(A) The strike prices are subject to adjustment in connection with return of capital dividends. A portion of Newcastle's 2008 dividends was deemed return of capital dividends. The effect on the strike prices was not significant. As of December 31, 2011, the weighted average strike price of the outstanding options issued prior to 2011 was \$26.64.

(B) The fair value of the options was estimated using an option valuation model. Since the Newcastle Option Plan has characteristics significantly different from those of traded options, and since the assumptions used in such model, particularly the volatility assumption, are subject to significant judgment and variability, the actual value of the options could vary materially from management's estimate.

The volatility assumption for these options was estimated based primarily on the historical volatility of Newcastle's common stock and management's expectations regarding future volatility. The expected life assumption for options issued prior to 2011 was estimated based on the simplified term method. This simplified method was used because Newcastle did not have sufficient historical data to conclude on the appropriate

## NEWCASTLE INVESTMENT CORP. AND SUBSIDIARIES

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expected life of its options and because historical data to date was consistent with the simplified term method. The expected life assumption for options issued in 2011 was estimated based primarily on the historical expected life of applicable previously issued options.

(C) The Manager assigned certain of its options to Fortress's employees as follows:

Date of Grant	Range of Strike Prices	Total Unexercised Inception to Date
2002	\$13.00	17,500
2003	\$20.35-\$22.85	164,197
2004	\$25.75-\$31.40	226,125
2005	\$29.60	90,750
2006	\$29.42	65,025
2007	\$27.75-\$31.30	234,565
	Total	798,162

(D) 670,620 of the total options exercised were by the Manager. 368,498 of the total options exercised were by employees of Fortress subsequent to their assignment. 4,000 of the total options exercised were by directors.

(E) The assumptions used in valuing the options were: a 1.7% risk-free rate, 107.8% volatility and a 3.3 year expected term.

(F) The assumptions used in valuing the options were: a 1.13% risk-free rate, 13.2% dividend yield, 151.1% volatility and a 4.6 year expected term.

### Preferred Stock

In March 2003, Newcastle issued 2.5 million shares (\$62.5 million face amount) of its 9.75% Series B Cumulative Redeemable Preferred Stock (the "Series B Preferred"). In October 2005, Newcastle issued 1.6 million shares (\$40.0 million face amount) of its 8.05% Series C Cumulative Redeemable Preferred Stock (the "Series C Preferred"). In March 2007, Newcastle issued 2.0 million shares (\$50.0 million face amount) of its 8.375% Series D Cumulative Redeemable Preferred Stock (the "Series D Preferred"). The Series B Preferred, Series C Preferred and Series D Preferred are non-voting, have a \$25 per share liquidation preference, no maturity date and no mandatory redemption. Newcastle has the option to redeem the Series B Preferred and the Series C Preferred, and, beginning in March 2012, Newcastle will have the option to redeem the Series D Preferred, at their liquidation preference. If the Series C Preferred or Series D Preferred cease to be listed on the NYSE or the AMEX, or quoted on the NASDAQ, and Newcastle is not subject to the reporting requirements of the Exchange Act, Newcastle has the option to redeem the Series C Preferred or Series D Preferred, as applicable, at their liquidation preference and, during such time any shares of Series C Preferred or Series D Preferred are outstanding, the dividend will increase to 9.05% or 9.375% per annum, respectively.

In connection with the issuance of the Series B Preferred, Series C Preferred and Series D Preferred, Newcastle incurred approximately \$2.4 million, \$1.5 million, and \$1.8 million of costs, respectively, which were netted against the proceeds of such offerings. If any series of preferred stock were redeemed, the related costs would be recorded as an adjustment to income available for common stockholders at that time.

In March 2010, Newcastle settled its offer to exchange (the "Exchange Offer") shares of its common stock and cash for shares of its preferred stock. In the aggregate, Newcastle issued 9,091,668 shares of its common stock (approximately 17.2% of Newcastle's outstanding shares of common stock prior to the issuance of shares in the Exchange Offer). A total of 2,881,694 shares of common stock were issued in exchange for 1,152,679 shares of Series B Preferred Stock, a total of 2,759,989 shares of common stock were issued in exchange for 1,104,000 shares of Series C Preferred Stock, and a total of 3,449,985 shares of common stock were issued in exchange for 1,380,000 shares of Series D Preferred Stock. The shares of Preferred Stock acquired by Newcastle in the Exchange Offer were retired upon receipt. After settlement of the Exchange Offer, 1,347,321 shares of Series B Preferred Stock, 496,000 shares of Series C Preferred Stock and 620,000 shares of Series D Preferred Stock remain outstanding for trading on the New York Stock Exchange.

The \$43.0 million excess of the \$87.5 million carrying value of the exchanged preferred stock over the \$44.5 million fair value of consideration paid (which included \$28.5 million of common stock and \$16.0 million of cash) was recorded as an increase to Net Income (Loss) Applicable to Common Stockholders.

As of January 31, 2012, Newcastle had paid all current and accrued dividends on its preferred stock.

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**10. MANAGEMENT AGREEMENT AND RELATED PARTY TRANSACTIONS****Manager**

Newcastle is party to a Management Agreement with its Manager which provides for automatically renewing one-year terms subject to certain termination rights. The Manager's performance is reviewed annually and the Management Agreement may be terminated by Newcastle by payment of a termination fee, as defined in the Management Agreement, equal to the amount of management fees earned by the Manager during the twelve consecutive calendar months immediately preceding the termination, upon the affirmative vote of at least two-thirds of the independent directors, or by a majority vote of the holders of common stock. Pursuant to the Management Agreement, the Manager, under the supervision of Newcastle's board of directors, formulates investment strategies, arranges for the acquisition of assets, arranges for financing, monitors the performance of Newcastle's assets and provides certain advisory, administrative and managerial services in connection with the operations of Newcastle. For performing these services, Newcastle pays the Manager an annual management fee equal to 1.5% of the gross equity of Newcastle, as defined, including adjustments for return of capital dividends.

The Management Agreement provides that Newcastle will reimburse the Manager for various expenses incurred by the Manager or its officers, employees and agents on Newcastle's behalf, including costs of legal, accounting, tax, auditing, administrative and other similar services rendered for Newcastle by providers retained by the Manager or, if provided by the Manager's employees, in amounts which are no greater than those which would be payable to outside professionals or consultants engaged to perform such services pursuant to agreements negotiated on an arm's-length basis.

To provide an incentive for the Manager to enhance the value of the common stock, the Manager is entitled to receive an incentive return (the "Incentive Compensation") on a cumulative, but not compounding, basis in an amount equal to the product of (A) 25% of the dollar amount by which (1) (a) the Funds from Operations (defined as the net income available for common stockholders before Incentive Compensation, excluding extraordinary items, plus depreciation of operating real estate and after adjustments for unconsolidated subsidiaries, if any) of Newcastle per share of common stock (based on the weighted average number of shares of common stock outstanding) plus (b) gains (or losses) from debt restructuring and from sales of property and other assets per share of common stock (based on the weighted average number of shares of common stock outstanding), exceed (2) an amount equal to (a) the weighted average of the price per share of common stock in the IPO and the value attributed to the net assets transferred to Newcastle by its predecessor, and in any subsequent offerings by Newcastle (adjusted for prior return of capital dividends or capital distributions) multiplied by (b) a simple interest rate of 10% per annum (divided by four to adjust for quarterly calculations) multiplied by (B) the weighted average number of shares of common stock outstanding.

	Amounts Incurred (in millions)		
	2011	2010	2009
Management Fee.....	\$17.8	\$16.8	\$17.5
Expense Reimbursement.....	0.5	0.5	0.5
Incentive Compensation.....	-	-	-

In 2009, principals of Fortress sold an aggregate of 1.1 million common shares of Newcastle to third parties at market prices.

In September 2011, certain principals of Fortress and officers of Newcastle participated in Newcastle's public offering (Note 1) and purchased an aggregate of 1,314,780 common shares at the offering price.

At December 31, 2011, Fortress, through its affiliates, and principals of Fortress, owned 4.8 million shares of Newcastle's common stock and Fortress, through its affiliates, had options to purchase an additional 6.0 million shares of Newcastle's common stock (Note 9).

At December 31, 2011 and 2010, Due To Affiliates was comprised of \$1.7 million and \$1.4 million, respectively, of management fees and expense reimbursements payable to the Manager.

**Other Affiliates**

In April 2006, Newcastle securitized Subprime Portfolio I and, through Securitization Trust 2006, entered into a servicing agreement with a subprime home equity mortgage lender (the "Subprime Servicer") to service this portfolio. In July 2006, private equity funds managed by an affiliate of Newcastle's manager completed the acquisition of the Subprime Servicer.

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As compensation under the servicing agreement, the Subprime Servicer will receive, on a monthly basis, a net servicing fee equal to 0.5% per annum on the unpaid principal balance of the portfolio. In March 2007, through Securitization Trust 2007, Newcastle entered into a servicing agreement with the Subprime Servicer to service Subprime Portfolio II under substantially the same terms. The outstanding unpaid principal balances of Subprime Portfolios I and II were approximately \$476.5 million and \$619.8 million at December 31, 2011, respectively.

In April 2010, Newcastle, through two of its CDOs, made a cash investment of \$75.0 million in a new real estate related loan to a portfolio company of a private equity fund managed by an affiliate of Newcastle's manager. Newcastle's chairman is an officer of the borrower. This investment improves the applicable CDOs' results under some of their respective tests, and is expected to yield approximately 22%. The loan will initially mature in April 2013, with two one-year extensions, and is secured by subordinated interests in the properties of the borrower. Interest on the loan will be accrued and deferred until maturity.

In January 2011, Newcastle, through two of its CDOs, made a cash investment of approximately \$47 million in a portion of a new secured loan to a portfolio company of a private equity fund managed by Newcastle's manager. Newcastle's chairman and secretary are officers or directors of the borrower. The terms of the loan were negotiated by a third party bank who acted as agent for the creditors on the loan. At closing, Newcastle received an origination fee on the loan equal to 2% of the amount of cash it loaned to the portfolio company, which was the same fee received by other creditors on the loan. In February 2011, the portfolio company repaid the loan in full.

See Note 5 for a discussion of the MSR Agreement and Recapture Agreement with Nationstar.

As of December 31, 2011, Newcastle held on its balance sheet total investments of \$247.0 million face amount of real estate securities and related loans issued by affiliates of the Manager. Newcastle earned approximately \$22.5 million, \$22.2 million and \$15.1 million of interest on investments issued by affiliates of the Manager for the years ended December 31, 2011, 2010 and 2009, respectively.

In each instance described above, affiliates of Newcastle's manager have an investment in the applicable affiliated fund and receive from the fund, in addition to management fees, incentive compensation if the fund's aggregate investment returns exceed certain thresholds.

## 11. COMMITMENTS AND CONTINGENCIES

**Stockholder Rights Agreement** — Newcastle has adopted a stockholder rights agreement (the "Rights Agreement"). Pursuant to the terms of the Rights Agreement, Newcastle will attach to each share of common stock one preferred stock purchase right (a "Right"). Each Right entitles the registered holder to purchase from Newcastle a unit consisting of one one-hundredth of a share of Series A Junior Participation Preferred Stock, par value \$0.01 per share, at a purchase price of \$70 per unit. Initially, the Rights are not exercisable and are attached to and transfer and trade with the outstanding shares of common stock. The Rights will separate from the common stock and will become exercisable upon the acquisition or tender offer to acquire a 15% beneficial ownership interest by an acquiring person, as defined. The effect of the Rights Agreement will be to dilute the acquiring party's beneficial interest. Until a Right is exercised, the holder thereof, as such, will have no rights as a stockholder of Newcastle.

**Litigation** — Newcastle is, from time to time, a defendant in legal actions from transactions conducted in the ordinary course of business. Management, after consultation with legal counsel, believes the ultimate liability arising from such actions, individually and in the aggregate, which existed at December 31, 2011, if any, will not materially affect Newcastle's consolidated results of operations or financial position.

**Environmental Costs** — As a commercial real estate owner, Newcastle is subject to potential environmental costs. At December 31, 2011, management of Newcastle is not aware of any environmental concerns that would have a material adverse effect on Newcastle's consolidated financial position or results of operations.

**Debt Covenants** — Newcastle's debt obligations contain various customary loan covenants. See Note 8.

**Subprime Securitizations** — Newcastle has no obligation to repurchase any loans from either of its subprime securitizations. Therefore, it is expected that Newcastle's exposure to loss is limited to the carrying amount of its retained interests in the securitization entities (Note 5). A subsidiary of Newcastle's gave limited representations and warranties with respect to the second securitization; however, it has no assets and does not have recourse to the general credit of Newcastle.

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**Contingent Gain in CDOs** — Newcastle cannot economically lose more than its investment amount in any given non-recourse financing structure. Therefore, impairment recorded in excess of such investment, which results in negative GAAP book value for a given non-recourse financing structure, cannot economically be incurred. For non-recourse financing structures with negative GAAP book value, the aggregate negative GAAP book value will eventually be recorded as an increase to GAAP book value. As of December 31, 2011, Newcastle has recorded \$166.4 million of losses in its CDOs in excess of its economic exposure which must eventually be reversed through amortization, sales at gains, or as reductions to accumulated deficit at the deconsolidation or termination of the CDOs.

**12. INCOME TAXES**

Newcastle Investment Corp. is organized and conducts its operations to qualify as a REIT under the Code. A REIT will generally not be subject to U.S. federal corporate income tax on that portion of its net income that is distributed to stockholders if it distributes at least 90% of its REIT taxable income to its stockholders by prescribed dates and complies with various other requirements. A portion of this distribution requirement may be met through stock dividends rather than cash, subject to limitations based on the value of Newcastle's stock.

Since Newcastle distributed 100% of its 2011, 2010 and 2009 REIT taxable income (if any), no provision has been made for U.S. federal corporate income taxes in the accompanying consolidated financial statements.

Common stock distributions relating to 2011, 2010, and 2009 were taxable as follows:

	Dividends Per Share		Ordinary/ Qualified Income	Capital Gains	Return of Capital
	Book Basis	Tax Basis			
2011	\$0.40	\$0.40	100.00%	None	0.00%
2010	\$0.00	\$0.00	0.00%	None	0.00%
2009	\$0.00	\$0.00	0.00%	None	0.00%

During 2010 and 2009, Newcastle repurchased an aggregate of \$787.8 million face amount of its outstanding CDO debt and junior subordinated notes at a discount and recorded \$521.1 million of aggregate gain. The gain recorded upon such cancellation of indebtedness is characterized as ordinary income for tax purposes. In compliance with current tax laws, Newcastle has the ability to defer such ordinary income to future years and has deferred all or a portion of such gain for 2010 and 2009. However, cancellation of indebtedness income recognized on or after January 1, 2011 cannot be deferred and must generally be recognized as ordinary income in the year of such cancellation. During 2011, Newcastle repurchased \$193.2 million face amount of its outstanding CDO debt and notes payable at a discount and recorded \$82.2 million of gain for tax purposes, of which only \$66.1 million gain relating to \$171.8 million face amount of debt repurchased was recognized for GAAP purposes. In addition, Newcastle may recognize material ordinary income from the cancellation of debt within its non-recourse financing structures, including its subprime securitizations, while losses on the related collateral may be recognized as capital losses. Through December 31, 2011, \$32.3 million of debt in Newcastle's subprime securitizations has been cancelled as a result of losses incurred on the underlying assets in the securitization trusts.

As of December 31, 2010, Newcastle had a loss carryforward, inclusive of net operating loss and capital loss, of approximately \$1.05 billion. The net operating loss carryforward and capital loss carryforward can generally be used to offset future ordinary taxable income and taxable capital gains, for up to 20 years and 5 years, respectively. The amounts of net operating loss carryforward and net long-term capital loss carryforward as of December 31, 2011 are subject to the finalization of the 2011 tax returns.

**13. SUBSEQUENT EVENTS**

These financial statements include a discussion of material events which have occurred subsequent to December 31, 2011 (referred to as "subsequent events") through the issuance of these consolidated financial statements. Events subsequent to that date have not been considered in these financial statements.

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On March 6, 2012, Newcastle entered into definitive agreements to acquire an investment in excess MSR in connection with Nationstar's acquisition of mortgage servicing assets from Aurora Bank FSB, a subsidiary of Lehman Brothers Bancorp Inc. Newcastle expects to invest approximately \$170 million to acquire an approximately 65% interest in the excess MSR on a portfolio of residential mortgage loans with an outstanding principal balance of approximately \$63 billion, comprised of approximately 75% non-conforming loans in private label securitizations and approximately 25% conforming loans in GSE pools. Nationstar will invest pari passu with Newcastle in approximately 35% of the excess MSR and will be the servicer of the loans performing all servicing and advancing functions, and retaining the ancillary income, servicing obligations and liabilities as the servicer. Under the terms of this investment, to the extent that any loans in the portfolio are refinanced by Nationstar, the resulting excess mortgage servicing rights will be shared pro rata by Newcastle and Nationstar, subject to certain limitations. The investment is expected to close in the second quarter of 2012 and is subject to regulatory and third-party approvals.

In March 2012, Newcastle repurchased \$30.0 million face amount of Newcastle CDO bonds for \$9.2 million. As a result, Newcastle extinguished \$30.0 million of CDO debt and recorded a gain on extinguishment of debt of \$20.7 million in the first quarter of 2012.

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**14. SUMMARY QUARTERLY CONSOLIDATED FINANCIAL INFORMATION (UNAUDITED)**

The following is unaudited summary information on Newcastle's quarterly operations.

	Quarter Ended				Year Ended
	March 31(A)	June 30 (A)	September 30 (A)	December 31	December 31
Interest income	\$ 72,203	\$ 74,143	\$ 72,393	\$ 73,557	\$ 292,296
Interest expense	38,165	35,750	32,587	31,533	138,035
Net interest income (expense)	34,038	38,393	39,806	42,024	154,261
Impairment, net of the reversal of prior valuation allowances on loans	(37,206)	(9,067)	21,650	25,300	677
Other income (loss) (B)	45,469	58,889	18,802	12,630	135,790
Expenses	6,850	7,404	7,166	8,813	30,233
Income (loss) from continuing operations	109,863	98,945	29,792	20,541	259,141
Income (loss) from discontinued operations	(190)	190	151	155	306
Preferred dividends	(1,395)	(1,395)	(1,395)	(1,395)	(5,580)
Income (loss) applicable to common stockholders	\$ 108,278	\$ 97,740	\$ 28,548	\$ 19,301	\$ 253,867
Net income (loss) per share of common stock					
Basic	\$ 1.73	\$ 1.23	\$ 0.35	\$ 0.18	\$ 3.09
Diluted	\$ 1.73	\$ 1.23	\$ 0.35	\$ 0.18	\$ 3.09
Income (loss) from continuing operations per share of common stock, after preferred dividends and related accretion					
Basic	\$ 1.73	\$ 1.23	\$ 0.35	\$ 0.18	\$ 3.09
Diluted	\$ 1.73	\$ 1.23	\$ 0.35	\$ 0.18	\$ 3.09
Income (loss) from discontinued operations per share of common stock					
Basic	\$ -	\$ -	\$ -	\$ -	\$ -
Diluted	\$ -	\$ -	\$ -	\$ -	\$ -
Weighted average number of shares of common stock outstanding					
Basic	62,602	79,282	80,425	105,175	81,984
Diluted	62,611	79,282	80,442	105,175	81,990

	Quarter Ended				Year Ended
	March 31(A)	June 30 (A)	September 30 (A)	December 31	December 31
Interest income	\$ 70,092	\$ 74,183	\$ 81,040	\$ 74,957	\$ 300,272
Interest expense	45,589	43,141	42,547	40,942	172,219
Net interest income (expense)	24,503	31,042	38,493	34,015	128,053
Impairment, net of the reversal of prior valuation allowances on loans	(68,032)	(42,495)	(95,319)	(35,012)	(240,858)
Other income (loss) (B)	56,543	53,384	36,662	135,698	282,287
Expenses	8,613	7,580	7,185	6,150	29,528
Income (loss) from continuing operations	140,465	119,341	163,289	198,575	621,670
Income (loss) from discontinued operations	(40)	13	213	(194)	(8)
Preferred dividends	(3,268)	(1,395)	(1,395)	(1,395)	(7,453)
Excess of carrying amount of exchanged preferred stock over fair value of consideration paid	43,043	-	-	-	43,043
Income (loss) applicable to common stockholders	\$ 180,200	\$ 117,959	\$ 162,107	\$ 196,986	\$ 657,252
Net income (loss) per share of common stock					
Basic	\$ 3.36	\$ 1.90	\$ 2.61	\$ 3.18	\$ 10.96
Diluted	\$ 3.36	\$ 1.90	\$ 2.61	\$ 3.18	\$ 10.96
Income (loss) from continuing operations per share of common stock, after preferred dividends and related accretion					
Basic	\$ 3.36	\$ 1.90	\$ 2.61	\$ 3.18	\$ 10.96
Diluted	\$ 3.36	\$ 1.90	\$ 2.61	\$ 3.18	\$ 10.96
Income (loss) from discontinued operations per share of common stock					
Basic	\$ -	\$ -	\$ -	\$ (0.01)	\$ -
Diluted	\$ -	\$ -	\$ -	\$ (0.01)	\$ -
Weighted average number of shares of common stock outstanding					
Basic	53,620	62,011	62,025	62,025	59,949
Diluted	53,620	62,011	62,025	62,025	59,949

(A) The Income Available for Common Stockholders shown agrees with Newcastle's quarterly report(s) on Form 10-Q as filed with the Securities and Exchange Commission. However, individual line items may vary from such report(s) due to the operations of properties sold, or classified as held for sale, during subsequent periods being retroactively reclassified to Income for Discontinued Operations for all periods presented (Note 5).

(B) Including equity in earnings of unconsolidated subsidiaries.

## **Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.**

None.

### **Item 9A. Controls and Procedures.**

- (a) **Disclosure Controls and Procedures.** The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this report. The Company's disclosure controls and procedures are designed to provide reasonable assurance that information is recorded, processed, summarized and reported accurately and on a timely basis. Based on such evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, the Company's disclosure controls and procedures are effective.
- (b) **Internal Control Over Financial Reporting.** There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Acts) during the most recent fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

### **Management's Report on Internal Control Over Financial Reporting**

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rule 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended, as a process designed by, or under the supervision of, the Company's principal executive and principal financial officers and effected by the Company's board of directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States and includes those policies and procedures that:

- pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect all misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2011. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control-Integrated Framework*.

Based on our assessment, management concluded that, as of December 31, 2011, the Company's internal control over financial reporting was effective.

The Company's independent registered public accounting firm has issued an audit report on the effectiveness of the Company's internal control over financial reporting. This report appears at the beginning of "Financial Statements and Supplementary Data."

## Item 9B. Other Information.

None.

## PART III

### Item 10. Directors, Executive Officers and Corporate Governance.

#### *Directors*

Set forth below is certain biographical information for our directors, as well as the month and year each director was first elected.

#### ***Wesley R. Edens***

Chairman of the board of directors since inception

Age: 50

Mr. Edens has been Chairman of our board of directors since inception. Mr. Edens also served as our Chief Executive Officer from our inception until February 2007. Mr. Edens is a principal and a Co-Chairman of the board of directors of Fortress Investment Group LLC, an affiliate of our manager. Mr. Edens has been a principal and a member of the Management Committee of Fortress since co-founding Fortress in May 1998. Mr. Edens is responsible for the private equity and publicly traded alternative investment businesses of Fortress Investment Group LLC. He is also Chairman of the board of directors of each of Aircastle Limited, Brookdale Senior Living Inc., Eurocastle Investment Limited, GateHouse Media, Inc., RailAmerica Inc., Seacastle Inc. and Mapeley Limited, Chairman and Chief Executive Officer of Newcastle Investment Holdings LLC (the predecessor of Newcastle) and a director of GAGFAH S.A. and Penn National Gaming Inc. Mr. Edens was the Chief Executive Officer of Global Signal Inc. from February 2004 to April 2006 and Chairman of the board of directors from October 2002 to January 2007. Mr. Edens serves or has served in various capacities in the following five current or former registered investment companies: Chairman, Chief Executive Officer and Trustee of Fortress Registered Investment Trust and Fortress Investment Trust II; Chairman and Chief Executive Officer of Fortress Brookdale Investment Fund LLC and Fortress Pinnacle Investment Fund LLC and Chief Executive Officer of RIC Coinvestment Fund GP LLC. Prior to forming Fortress Investment Group LLC, Mr. Edens was a partner and a managing director of BlackRock Financial Management Inc., where he headed BlackRock Asset Investors, a private equity fund. In addition, Mr. Edens was formerly a partner and a managing director of Lehman Brothers. As a result of his past experiences, Mr. Edens has private equity finance and management expertise and a deep familiarity with our Company. These factors and his other qualifications and skills, led our board of directors to conclude that Mr. Edens should be elected to serve as a director.

***Kevin J. Finnerty***

Director since August 2005

Age: 57

Mr. Finnerty has been a member of our board of directors and a member of the Audit Committee, Nominating and Corporate Governance Committee and Compensation Committee of our board of directors since August 2005. Mr. Finnerty has been a director of Newcastle Investment Holdings LLC (the predecessor of Newcastle) since its inception in 1998. Mr. Finnerty is the Founding Partner of Galton Capital Group, a residential mortgage credit fund manager. Mr. Finnerty is a former founder and the Managing Partner of F.I. Capital Management, an investment company focused on agency-mortgage related strategies. Previously, Mr. Finnerty was a Managing Director at J.P. Morgan Securities Inc., where he headed the Residential Mortgage Securities Department. Mr. Finnerty joined Chase Securities Inc. in December of 1999. Prior to joining Chase Securities Inc., Mr. Finnerty worked at Union Bank of Switzerland from November 1996 until February 1998, where he headed the Mortgage Backed Securities Department, and at Freddie Mac from January 1999 until June 1999, where he was a Senior Vice President. Between 1986 and 1996, Mr. Finnerty was with Bear Stearns & Co. Inc., where he was a Senior Managing Director and ultimately headed the MBS Department and served as a member of the board of directors from 1993 until 1996. Mr. Finnerty was Co-Chair of the North American People Committee at JPMorganChase and Chairman of the Mortgage and Asset-Backed Division of the Bond Market Association for the year 2003. Mr. Finnerty's knowledge, skill, expertise and experience as described above, as well as his deep familiarity with our Company, led the board of directors to conclude that Mr. Finnerty should be elected to serve as a director.

***Stuart A. McFarland***

Director since October 2002

Age: 65

Mr. McFarland has been a member of our board of directors since October 2002 and a member of the Audit Committee, Nominating and Corporate Governance Committee and Compensation Committee of our board of directors since November 2002. Mr. McFarland was a director of Newcastle Investment Holdings LLC (the predecessor of Newcastle) from May 1998 until October 2002. Mr. McFarland was Chairman of Federal City Bancorp, Inc., a Managing Partner of Federal City Capital Advisors, LLC and President and Chief Executive Officer of Pedestal Inc., an internet secondary mortgage market trading exchange. Mr. McFarland was Executive Vice President and General Manager of GE Capital Mortgage Services and President and CEO of GE Capital Asset Management Corporation from 1990 to 1995. Prior to GE Capital, Mr. McFarland was President and CEO of Skyline Financial Services Corp. Before joining Skyline, Mr. McFarland was President and CEO of National Permanent Federal Savings Bank in Washington, D.C. Prior to that, Mr. McFarland was Executive Vice President - Operations and Chief Financial Officer with Fannie Mae (Federal National Mortgage Association). From 1972 to 1981, he was President and Director of Ticor Mortgage Insurance Company in Los Angeles, California. Mr. McFarland presently serves as the Lead Independent Director of the Brandywine Funds and a director of the Brookfield HELIOS Funds. Mr. McFarland also serves as a Director and Member of the Executive Committee of the Center for Housing Policy and is a member of the Trustees Council of the National Building. Mr. McFarland's knowledge, skill, expertise and experience as described above, as well as his deep familiarity with our Company, led the board of directors to conclude that Mr. McFarland should be elected to serve as a director.

**David K. McKown**

Director since November 2002

Age: 74

Mr. McKown has been a member of our board of directors and a member of the Audit Committee, Nominating and Corporate Governance Committee and Compensation Committee of our board of directors since November 2002. Mr. McKown is a member of the board of directors for Global Partners LP, where he serves on the Conflicts Committee, the Compensation Committee and the Audit Committee and is a member of Safety Insurance Group’s board of directors where he serves on the Nominating and Corporate Governance Committee, the Compensation Committee and the Audit Committee. Mr. McKown also serves as a director of Friends of Post Office Square, POWDR Corp., Local TV LLC and Foxco TV LLC. Mr. McKown has been a senior advisor to Eaton Vance Management, an investment fund manager located in Boston, Massachusetts, since May 2000. Mr. McKown retired from the BankBoston, N.A. in 2000 as a Group Executive. Mr. McKown was a trustee of Equity Office Properties Trust from July 1997 to May 2006 where he served on the Executive, Compensation and Option and Conflicts Committees. Mr. McKown was also a director at American Investment Bank. Mr. McKown holds advisory directorships with Eiger Fund and Alliance Energy, Inc. Mr. McKown’s knowledge, skill, expertise and experience as described above, as well as his deep familiarity with our Company, led the board of directors to conclude that Mr. McKown should be elected to serve as a director.

**Kenneth M. Riis**

Director since February 2007

Age: 52

Mr. Riis was appointed Chief Executive Officer by our board of directors on February 21, 2007. On that date, Mr. Riis was also unanimously elected as one of our directors. Mr. Riis has been our President since our inception and a Managing Director of our manager, an affiliate of Fortress Investment Group LLC, since December 2001. Mr. Riis is also the President of Newcastle Investment Holdings LLC (the predecessor of Newcastle). From November 1996 to December 2001, Mr. Riis was an independent consultant for our manager as well as other financial companies. From 1989 to 1996, Mr. Riis was a Principal and Managing Director of the real estate finance group at Donaldson, Lufkin & Jenrette. Mr. Riis’s knowledge, skill, expertise and experience as described above, as well as his deep familiarity with our Company, led the board of directors to conclude that Mr. Riis should be elected to serve as a director.

**Alan L. Tyson**

Director since November 2011

Age: 55

Mr. Tyson has been a member of our board of directors and a member of the Audit Committee, Nominating and Corporate Governance Committee, and Compensation Committee of our board of directors since November 2011. Mr. Tyson is a private investor. He retired as Managing Director of Credit Suisse in October 2011, where he worked for 18 years in the Sales and Trading area of the Fixed Income Department of the Investment Bank. Mr. Tyson began his career at L. F. Rothschild, Unterberg Towbin and subsequently worked at Smith Barney and Lehman Brothers before joining Donaldson, Lufkin and Jenrette in 1994, which was acquired by Credit Suisse in 2000. Mr. Tyson’s knowledge, skill, expertise and experience as described above led the board of directors to conclude that Mr. Tyson should be elected to serve as a director.

**Executive Officers**

The following table shows the names and ages of our present executive officers and certain other corporate officers and the positions held by each individual. A description of the business experience of each for at least the past five years follows the table.

<u>Name</u>	<u>Age</u>	<u>Position</u>
Wesley R. Edens .....	50	Chairman of the board of directors
Kenneth M. Riis .....	52	Chief Executive Officer and President
Brian C. Sigman.....	34	Chief Financial Officer and Treasurer
Jonathan Ashley .....	46	Chief Operating Officer
Randal A. Nardone.....	56	Secretary

**Wesley R. Edens** For information regarding Mr. Edens, see above.

**Kenneth M. Riis** For information regarding Mr. Riis, see above.

**Brian C. Sigman** has been our Chief Financial Officer since August 2008. Mr. Sigman is a Managing Director of our manager, an affiliate of Fortress Investment Group LLC. Mr. Sigman served as our Vice President of Finance from 2006 to 2008. Prior to that time, Mr. Sigman served as our Assistant Controller from 2003 through 2006. From 1999 to 2003, Mr. Sigman was a Senior Auditor at Ernst & Young LLP.

**Jonathan Ashley** has been our Chief Operating Officer, Principal Accounting Officer and Treasurer since our inception. Mr. Ashley is a Managing Director of our manager, an affiliate of Fortress Investment Group LLC, since its formation in May 1998. Mr. Ashley is also a Vice President and the Chief Operating Officer of Newcastle Investment Holdings LLC (the predecessor of Newcastle). Mr. Ashley previously worked for Union Bank of Switzerland from May 1997 to May 1998. Prior to joining Union Bank of Switzerland, Mr. Ashley worked for an affiliate of BlackRock Financial Management, Inc. from April 1996 to May 1997. Prior to joining BlackRock, Mr. Ashley worked at Morgan Stanley, Inc. in its Real Estate Investment Banking Group. Prior to joining Morgan Stanley, Mr. Ashley was in the Structured Finance Group at the law firm of Skadden, Arps, Slate, Meagher & Flom LLP.

**Randal A. Nardone** has been our Secretary since our inception. Mr. Nardone is a principal and a member of the board of directors of Fortress Investment Group LLC. Mr. Nardone has been a principal and a member of the Management Committee of Fortress since co-founding Fortress in 1998. Mr. Nardone is a director of Brookdale Senior Living, Inc., Alea Group Holding (Bermuda) Ltd., GAGFAH S.A. and Eurocastle Investment Limited. Mr. Nardone is also a Vice President and the Secretary of Newcastle Investment Holdings LLC (the predecessor of Newcastle). Mr. Nardone was previously a managing director of UBS from May 1997 to May 1998. Prior to joining UBS in 1997, Mr. Nardone was a principal of BlackRock Financial Management, Inc. Prior to joining BlackRock, Mr. Nardone was a partner and a member of the executive committee at the law firm of Thacher Proffitt & Wood.

**Phillip J. Evanski** became our Chief Investment Officer in June 2006. Mr. Evanski is a Managing Director of our manager, an affiliate of Fortress Investment Group LLC. Mr. Evanski was previously with Nomura Securities since 2004 where he was a Managing Director and Head of CMBS Trading and Syndicate. Prior to that, Mr. Evanski was a Senior Vice President and Principal for Realm Business Solutions, Inc. From 1999 to 2000, he was a Vice President at JP Morgan in London with responsibility for Structured Product Syndicate and Trading. Prior to that, Mr. Evanski was a Senior Vice President and Head of the Asset Securitization Group for Donaldson, Lufkin & Jenrette between 1998 and 1999 in London. From 1992 to 1998 Mr. Evanski was a Senior Vice President and Head of CMBS Trading and Syndicate for Donaldson, Lufkin & Jenrette in New York. As of January 2012, Mr. Evanski no longer serves as our Chief Investment Officer.

#### *Involvement in Certain Legal Proceedings*

There are no legal proceedings ongoing as to which any director, officer or affiliate of the Company, or, to the knowledge of the Company, any owner of record or beneficially of more than five percent of any class of voting securities of the Company, or any associate of any such director, officer, affiliate of the Company, or security holder is a party adverse to us or any of our subsidiaries or has a material interest adverse to us or any of our subsidiaries.

#### *Compliance with Section 16(a) of the Exchange Act*

Section 16(a) of the Exchange Act requires directors, executive officers and persons beneficially owning more than ten percent of a registered class of a company's equity securities to file reports of ownership and changes in ownership on Forms 3, 4, and 5 with the SEC and the NYSE.

To our knowledge, based solely on review of the copies of such reports furnished to us during the year ended December 31, 2011, all reports required to be filed by our directors, executive officers and greater-than-ten-percent owners were in compliance with the Section 16(a) filing requirements.

#### *Code of Ethics*

We have adopted Corporate Governance Guidelines and a Code of Business Conduct and Ethics, which delineate our standards for our officers and directors, and employee of our manager, and affiliate of Fortress Investment Group LLC. We have also adopted a Code of Ethics for Principal Executive Officers and Senior Financial Officers, which sets forth specific policies to guide the Company's senior officers in the performance of their duties. This code supplements the Code of Business Conduct and Ethics described above. These policies are available free of charge on our website, [www.newcastleinv.com](http://www.newcastleinv.com).

### *Nominating and Corporate Governance Committee*

Our board of directors has a standing Nominating and Corporate Governance Committee composed exclusively of independent directors. The current members of the Nominating and Corporate Governance Committee are Messrs. Finnerty, McFarland, McKown and Tyson (Chairman), each of whom has been determined by our board of directors to be an independent director in accordance with the rules of the New York Stock Exchange. The functions of the Nominating and Corporate Governance Committee include, without limitation, the following: (a) recommending to the board individuals qualified to serve as directors of the Company and on committees of the board; (b) advising the board with respect to board composition, procedures and committees; (c) advising the board with respect to the corporate governance principles applicable to the Company; and (d) overseeing the evaluation of the board. The charter of the Nominating and Corporate Governance Committee is available on our website, at [www.newcastleinv.com](http://www.newcastleinv.com). You may also obtain the charter by writing the Company at 1345 Avenue of the Americas, 46th Floor, New York, New York 10105, Attention: Investor Relations.

The Nominating and Corporate Governance Committee, as required by the Company's Bylaws, will consider director candidates recommended by stockholders. In considering candidates submitted by stockholders, the Nominating and Corporate Governance Committee will take into consideration the needs of the board of directors and the qualifications of the candidate and may take into consideration the number of shares held by the recommending stockholder and the length of time that such shares have been held.

The Company's Bylaws provide certain procedures that a stockholder must follow to nominate persons for election to the board of directors. Nominations for director at an annual stockholder meeting must be submitted in writing to the Company's Secretary at Newcastle Investment Corp., 1345 Avenue of the Americas, 46th Floor, New York, New York 10105. The Secretary must receive the notice of a stockholder's intention to introduce a nomination at an annual stockholders meeting (together with certain required information set forth in the Company's Bylaws) not later than the close of business on the 90th day nor earlier than the close of business on the 120th day prior to the first anniversary of the preceding year's annual meeting; or in the event that the date of the annual meeting is advanced or delayed by more than 30 days from such anniversary date, not earlier than the close of business on the 120th day prior to the date of mailing of the notice for such annual meeting and not later than the close of business on the later of the 90th day prior to the date of mailing of the notice for such annual meeting or the 10th day following the day on which public announcement of the date of such meeting is first made by the Company.

The Nominating and Corporate Governance Committee believes that the qualifications for serving as a director of the Company are possession, taking into account such person's familiarity with the Company, of such knowledge, experience, skills, expertise, integrity and diversity as would enhance the board's ability to manage and direct the affairs and business of the Company, including, when applicable, the ability of committees of the board to fulfill their duties and/or to satisfy any independence requirements imposed by law, regulation or NYSE listing requirement.

In addition to considering a director-candidate's background and accomplishments, the process for identifying and evaluating all nominees includes a review of the current composition of the board of directors and the evolving needs of our business. The Nominating and Corporate Governance Committee will identify potential nominees by asking current directors and executive officers to notify the Committee if they become aware of suitable candidates. The Nominating and Corporate Governance Committee also may, from time to time, engage firms that specialize in identifying director candidates. As described above, the Committee will also consider candidates recommended by stockholders. Our evaluation of nominees does not necessarily vary depending on whether or not the nominee was nominated by a stockholder. In considering candidates submitted by stockholders, the Nominating and Corporate Governance Committee may take into consideration the number of shares held by the recommending stockholder and the length of time that such shares have been held. We do not have a formal policy with regard to the consideration of diversity in identifying director-nominees, but the Nominating and Corporate Governance Committee strives to nominate individuals with a variety of complementary skills.

### *Audit Committee*

Our board of directors has a standing Audit Committee composed exclusively of independent directors. The current members of the Audit Committee are Messrs. Finnerty, McFarland (Chairman), McKown and Tyson, each of whom has been determined by our board of directors to be independent in accordance with the rules of the New York Stock Exchange and the SEC's audit committee independence standards. The purpose of the Audit Committee is to provide assistance to the board in fulfilling its legal and fiduciary obligations with respect to matters involving the accounting, auditing, financial reporting, internal control and legal compliance functions of the Company and its subsidiaries, including, without limitation, assisting the board's oversight of (a) the integrity of the Company's financial statements; (b) the Company's compliance with legal and regulatory requirements; (c) the Company's independent registered public accounting firm's qualifications and independence; and (d) the performance of the Company's independent registered public accounting firm

and the Company's internal audit function. The Audit Committee is also responsible for appointing the Company's independent registered public accounting firm and approving the terms of the registered public accounting firm's services. The Audit Committee operates pursuant to a charter, which is available on our website, [www.newcastleinv.com](http://www.newcastleinv.com). You may also obtain the charter by writing the Company at 1345 Avenue of the Americas, 46th Floor, New York, New York 10105, Attention: Investor Relations.

The board has determined that Mr. McFarland qualifies as an "Audit Committee Financial Expert" as defined by the rules of the SEC. As noted above, our board of directors has determined that Mr. McFarland is independent under NYSE and SEC standards.

#### **Item 11. Executive Compensation.**

We are party to a management agreement with an affiliate of Fortress Investment Group LLC, pursuant to which our manager provides for the day-to-day management of our operations.

The management agreement requires our manager to manage our business affairs under the direction of our board of directors and in conformity with the policies and the investment guidelines that are approved and monitored by our board of directors. Our manager is responsible for, among other things, (i) the purchase and sale of real estate securities, real estate related loans and other real estate related assets, (ii) the financing of such investments, (iii) management of our real estate, including arranging for purchases, sales, leases, maintenance and insurance, (iv) the purchase, sale and servicing of loans for us, and (v) investment advisory services. Our manager is also responsible for our day-to-day operations and performs (or causes to be performed) such other services and activities relating to our assets and operations as may be appropriate.

We pay our manager an annual management fee equal to 1.5% of our gross equity. Gross equity, as defined in the management agreement, is generally equal to the aggregate of the net proceeds from all equity offerings made by the Company, reduced for any return of capital distributions made by the Company, and adjusted for any stock splits, stock dividends or similar transactions. In computing the management fee for a particular period, the weighted average gross equity of the Company for that period is used, weighted based upon the number of days a particular transaction impacted gross equity during the period and upon the size of such transaction(s). The management fee for 2011 was computed as the weighted average gross equity for 2011 multiplied by 1.5%.

To provide an incentive for our manager to enhance the value of our Common Stock, our manager is entitled to receive an annual incentive return (the "Incentive Compensation") on a cumulative, but not compounding, basis in an amount equal to the product of (A) 25% of the dollar amount by which (1) (a) our funds from operations, as defined (before the Incentive Compensation) per share of Common Stock (based on the weighted average number of shares of Common Stock outstanding) plus (b) gains (or losses) from debt restructuring and from sales of property per share of Common Stock (based on the weighted average number of shares of Common Stock outstanding), exceed (2) an amount equal to (a) the weighted average of the book value per share of Common Stock of the net assets transferred to us on or prior to July 12, 2002, by Newcastle Investment Holdings Corp., and the price per share of Common Stock in any of our subsequent offerings (adjusted for prior capital dividends or capital distributions) multiplied by (b) a simple interest rate of 10% per annum multiplied by (B) the weighted average number of shares of our Common Stock outstanding during such period. Our manager earned no incentive compensation during 2011.

The management agreement provides for automatic one-year extensions. Our independent directors review our manager's performance annually and the management agreement may be terminated annually upon the affirmative vote of at least two-thirds of our independent directors, or by a vote of the holders of a majority of the outstanding shares of our Common Stock, based upon unsatisfactory performance that is materially detrimental to us or a determination by our independent directors that the management fee earned by our manager is not fair, subject to our manager's right to prevent such a termination by accepting a mutually acceptable reduction of fees. Our manager would be provided with 60 days' prior notice of any such termination and paid a termination fee equal to the amount of the management fee earned by our manager during the twelve-month period preceding such termination which may make it more difficult for us to terminate the management agreement. Following any termination of the management agreement, we have the option to purchase our manager's right to receive the Incentive Compensation at a cash price equal to the amount of the Incentive Compensation that would be paid to the manager if our assets were sold for cash at their then current fair market value (as determined by an appraisal, taking into account, among other things, the expected future value of the underlying investments) or otherwise we may continue to pay the Incentive Compensation to our manager. In addition, were we to not purchase our manager's Incentive Compensation, our manager may require us to purchase the same at the price discussed above. In addition, the management agreement may be terminated by us at any time for cause.

Because our management agreement provides that our manager will assume principal responsibility for managing our affairs, our officers, in their capacities as such, do not receive any cash compensation directly from us. However, in their capacities as officers or employees of our manager, or its affiliates, they devote such portion of their time to our affairs as is required for the performance of the duties of our manager under the management agreement. Our manager has informed us that, because the services performed by its officers or employees in their capacities as such are not performed exclusively

for us, it cannot segregate and identify that portion of the compensation awarded to, earned by or paid to our named executive officers by the manager that relates solely to their services to us. We may, from time to time, at the discretion of the Compensation Committee of the board of directors, grant options to purchase shares of our Common Stock or other equity interests in us to an affiliate of our manager, who may in turn assign a portion of the options to its employees, including our named executive officers.

Below is a summary of the fees and other amounts earned by our manager in connection with services performed for us during fiscal year 2011.

	<u>2011</u>
Management Fee <sup>(1)</sup> .....	\$ 17.8 million
Expense Reimbursements <sup>(2)</sup> .....	\$ 0.5 million
Incentive Compensation <sup>(3)</sup> .....	None
Stock Options .....	4,312,500 shares

- (1) We pay our manager an annual management fee equal to 1.5% of our gross equity, as defined in our management agreement. Our manager uses the proceeds from its management fee in part to pay compensation to its officers and employees who, notwithstanding that certain of them also are our officers, receive no cash compensation directly from us.
- (2) The management agreement provides that we will reimburse our manager for various expenses incurred by our manager or its officers, employees and agents on our behalf, including costs of legal, accounting, tax, auditing, administrative and other similar services rendered for us by providers retained by our manager or, if provided by our manager's employees, in amounts which are no greater than those which would be payable to outside professionals or consultants engaged to perform such services pursuant to agreements negotiated on an arm's-length basis; certain of such services are provided by our manager. The management agreement provides that such costs shall not be reimbursed in excess of \$500,000 per annum. We also pay all of our operating expenses, except those specifically required to be borne by our manager under the management agreement. Our manager is responsible for all costs incident to the performance of its duties under the management agreement, including compensation of our manager's employees, rent for facilities and other "overhead" expenses. The expenses required to be paid by us include, but are not limited to, issuance and transaction costs incident to the acquisition, disposition and financing of our investments, legal and auditing fees and expenses, the compensation and expenses of our independent directors, the costs associated with the establishment and maintenance of any credit facilities and other indebtedness of ours (including commitment fees, legal fees, closing costs, etc.), expenses associated with other securities offerings of ours, the costs of printing and mailing proxies and reports to our stockholders, costs incurred by employees of our manager for travel on our behalf, costs associated with any computer software or hardware that is used solely for us, costs to obtain liability insurance to indemnify our directors and officers, the compensation and expenses of our transfer agent and fees payable to the NYSE.
- (3) Our manager is entitled to receive the Incentive Compensation pursuant to the terms of the management agreement with us. The purpose of the Incentive Compensation is to provide an additional incentive for our manager to achieve targeted levels of funds from operations (including gains and losses) and to increase our stockholder value. Our board of directors may request that our manager accept all or a portion of its Incentive Compensation in shares of our Common Stock, and our manager may elect, in its discretion, to accept such payment in the form of shares, subject to limitations that may be imposed by the rules of the NYSE or otherwise.

As of February 29, 2012, Fortress through its affiliates, and principals of Fortress, owned 4,848,139 shares of our Common Stock and Fortress, through its affiliates owned options to purchase an additional 5,998,947 shares of our Common Stock, which were issued in connection with our equity offerings, representing approximately 9.7% of our Common Stock on a fully diluted basis.

### Grants of Plan-Based Awards in 2011

On March 29, 2011 and September 27, 2011, we granted 1,725,000 options and 2,587,500 options, respectively, to an affiliate of our manager. The exercise prices were \$6.00 and \$4.55 per option, respectively, which, pursuant to the policy explained in more detail below, is equal to the price per share at which we sold shares of our Common Stock on that same day. The closing price per share of our Common Stock on the grant dates were \$5.96 and \$4.50, respectively. The table below sets forth certain information regarding the grants of such options to our named executive officers:

<u>Name</u>	<u>Grant Date</u>	<u>Number of Options</u> <sup>(1)</sup>	<u>Exercise Price</u>	<u>Grant Date Closing Price of Common Stock</u>	<u>Grant Date Fair Value of Option Awards</u> <sup>(2)</sup>
Wesley R. Edens.....	3/29/2011	1,725,000	\$6.00	\$5.96	\$7,020,750
Wesley R. Edens.....	9/27/2011	2,587,500	\$4.55	\$4.50	\$5,594,114
Randal A. Nardone.....	3/29/2011	1,725,000	\$6.00	\$5.96	\$7,020,750
Randal A. Nardone.....	9/27/2011	2,587,500	\$4.55	\$4.50	\$5,594,114

- (1) As mentioned above, on March 29, 2011 and September 27, 2011, we granted 1,725,000 and 2,587,500 options, respectively, to Fortress Operating Entity I ("FOE I," which was formerly known as Fortress Investment Holdings LLC). Mr. Edens and Mr. Nardone, as beneficial owners of FOE I, may be considered to have, together with the other beneficial owners of FOE I, shared voting and investment power with respect to the shares

issuable upon exercise of options held by FOE I. Each of Mr. Edens and Mr. Nardone disclaims beneficial ownership of the options held by and of the shares received upon the exercise of options held by FOE I except, in each case, to the extent of his pecuniary interest therein.

(2) Represents the grant dates fair value of the option awards determined under FASB ASC Topic 718. For information regarding assumptions used in determining such valuation, please see Note 9 to the Company's consolidated financial statements included in this Form 10-K.

### Outstanding Option Awards As of December 31, 2011

Name	Number of Securities Underlying Unexercised Options Exercisable	Number of Securities Underlying Unexercised Option Unexercisable	Option Exercise Price	Option Expiration Date	
Wesley R. Edens <sup>(1)</sup> .....	14,000	-	\$12.60	10/10/2012	
	35,880	-	\$19.95	7/16/2013	
	220,907	-	\$22.45	12/1/2013	
	239,250	-	\$25.90	1/9/2014	
	250,125	-	\$25.35	5/25/2014	
	118,625	-	\$31.00	11/22/2014	
	239,250	-	\$29.20	1/12/2015	
	104,975	-	\$29.02	11/1/2016	
	148,225	-	\$30.90	1/23/2017	
	315,210	-	\$27.35	4/11/2017	
	517,500	1,207,500	\$6.00	3/29/2021	
	258,750	2,328,750	\$4.55	9/27/2021	
	Randal A. Nardone <sup>(1)</sup> .....	14,000	-	\$12.60	10/10/2012
		35,880	-	\$19.95	7/16/2013
220,907		-	\$22.45	12/1/2013	
239,250		-	\$25.90	1/9/2014	
250,125		-	\$25.35	5/25/2014	
118,625		-	\$31.00	11/22/2014	
239,250		-	\$29.20	1/12/2015	
104,975		-	\$29.02	11/1/2016	
148,225		-	\$30.90	1/23/2017	
315,210		-	\$27.35	4/11/2017	
517,500		1,207,500	\$6.00	3/29/2021	
258,750		2,328,750	\$4.55	9/27/2021	
Kenneth M. Riis .....		17,500	-	\$12.60	10/10/2012
		80,500	-	\$19.95	7/16/2013
	57,438	-	\$22.45	12/1/2013	
	57,750	-	\$25.90	1/9/2014	
	60,375	-	\$25.35	5/25/2014	
	28,437	-	\$31.00	11/22/2014	
	57,750	-	\$29.20	1/12/2015	
	29,750	-	\$29.02	11/1/2016	
	42,350	-	\$30.90	1/23/2017	
	58,140	-	\$27.35	4/11/2017	
	Brian C. Sigman .....	425	-	\$29.02	11/1/2016
		605	-	\$30.90	1/23/2017
		1,140	-	\$27.35	4/11/2017
	Jonathan Ashley .....	19,694	-	\$22.45	12/1/2013
19,800		-	\$25.90	1/9/2014	
20,700		-	\$25.35	5/25/2014	
9,750		-	\$31.00	11/22/2014	
19,800		-	\$29.20	1/12/2015	
10,200		-	\$29.02	11/1/2016	
14,520		-	\$30.90	1/23/2017	
13,680		-	\$27.35	4/11/2017	
Phillip Evanski .....	13,600	-	\$29.02	11/1/2016	
	19,360	-	\$30.90	1/23/2017	
	31,920	-	\$27.35	4/11/2017	

- (1) Represents options held as of December 31, 2011, by FOE I. Mr. Edens and Mr. Nardone, as beneficial owners of FOE I, may be considered to have, together with the other beneficial owners of FOE I, shared voting and investment power with respect to the shares issuable upon the exercise of options held by FOE I. Each of Mr. Edens and Mr. Nardone disclaims beneficial ownership of the options held by and of the shares received upon the exercise of options held by FOE I except, in each case, to the extent of his pecuniary interest therein.

### Director Compensation Table

Name	Fees Earned or Paid			Option Awards	Total
	in Cash	Stock Awards <sup>(1)</sup>			
Wesley R. Edens .....	\$ 0	\$ 0	—		\$ 0
Kenneth M. Riis .....	\$ 0	\$ 0	—		\$ 0
Kevin J. Finnerty <sup>(2)</sup> .....	\$ 0	\$ 70,000	—		\$ 70,000
Stuart A. McFarland .....	\$ 55,000	\$ 25,000	—		\$ 80,000
David K. McKown .....	\$ 45,000	\$ 25,000	—		\$ 70,000
Peter M. Miller <sup>(3)</sup> .....	\$ 29,470	\$ 25,000	—		\$ 54,470
Alan L. Tyson <sup>(4)</sup> .....	\$ 0	\$ 4,524	\$ 4,964		\$ 9,488

- (1) Pursuant to our Stock Incentive Plan and the additional terms established by resolution of the board of directors, each non-employee director received an automatic annual award of our Common Stock effective on the first business day after our annual meeting of stockholders valued at \$25,000 based on the per share closing price of our Common Stock on the New York Stock Exchange on the date of such grant. In 2011, such directors accordingly received 4,780 shares of Common Stock.
- (2) In 2011, Mr. Finnerty elected to receive \$45,000 of compensation for his services as a director in the form of Common Stock in lieu of cash.
- (3) Mr. Miller resigned from our board of directors effective as of August 26, 2011.
- (4) Mr. Tyson was elected to our board of directors on November 25, 2011. Mr. Tyson elected to receive his prorated director's compensation in 2011 in the amount of \$4,524 in the form of Common Stock in lieu of cash and received an initial option grant to purchase 2,000 shares of our Common Stock pursuant to our Stock Incentive Plan. The options to purchase 2,000 shares of our Common Stock were valued at \$4,964 as of the grant date. The assumptions used in valuing the options were: a 1.2% risk-free rate, 12.0% dividend yield, 149.2% volatility and a 4.7 year expected term.

### Potential Payments Upon Termination or Change-in-Control

According to the terms of our Stock Incentive Plan and related award agreements, options and tandem awards granted pursuant to the plan shall become immediately and fully vested and exercisable upon a change in control. However, no optionholder will be entitled to receive any payment or other items of value upon a change in control.

The following table lists the named executive officers and the estimated fair value of the option awards that would have been accelerated had a change in control occurred on December 31, 2011.

Name	Estimated Total Value of Option Awards Accelerated Upon a Change in Control
Wesley R. Edens.....	\$8,385,225
Randal A. Nardone.....	\$8,385,225

### Newcastle Investment Corp. Nonqualified Stock Option and Incentive Award Plan

In 2002, we adopted the Newcastle Investment Corp. Nonqualified Stock Option and Incentive Award Plan, referred to herein as the Stock Incentive Plan, to provide incentives to attract and retain the highest qualified directors, officers, employees, advisors, consultants and other personnel. We intend to replace this plan with the 2012 Non-Qualified Stock Option and Incentive Award Plan, if such plan is approved by our shareholders. The Stock Incentive Plan is administered by our Compensation Committee. The maximum number of shares of our Common Stock reserved and available for issuance for our first fiscal year was 5,000,000 shares. For each year thereafter, the maximum number of shares available for issuance under the Stock Incentive Plan is that number of shares equal to 15% of the number of our outstanding equity interests, but in no event more than 10,000,000 shares in the aggregate over the term of the plan. No stock option may be granted to our manager (or its designee) in connection with any issuance by us of equity securities in excess of ten percent (10%) of the number of equity securities then being issued. The Stock Incentive Plan permits the granting of options to purchase Common Stock that do not qualify as incentive stock options under section 422 of the Internal Revenue Code.

As the administrator of the Stock Incentive Plan, the Compensation Committee has the authority to establish terms and procedures related to all option grants made under the plan. For example, the exercise price of each option is determined in accordance with procedures approved by the Compensation Committee and may be less than 100% of the fair market value of our Common Stock subject to such option on the date of grant. Under the current policy approved by the Compensation Committee, we grant our manager, through affiliates, options only in connection with our equity offerings. In the event that

we offer common stock to the public, we simultaneously grant to our manager or an affiliate of our manager a number of options equal to 10% of the aggregate number of shares being offering in such offering at an exercise price per share equal to the public offering price per share; provided that if there is no fixed public offering price, we will grant such options at an exercise price per share equal to the price per share that we sold the Common Stock to the underwriters in such offering. In each case, the options are exercisable as to 1/30 of the shares subject to the option on the first day of each of the 30 calendar months following the first month after the date of the grant.

As a general matter, the Stock Incentive Plan provides that the Compensation Committee has the power to determine at what time or times each option may be exercised and, subject to the provisions of the Stock Incentive Plan, the period of time, if any, after retirement, death, disability or termination of employment during which options may be exercised. Options may become vested and exercisable in installments, and the exercisability of options may be accelerated by the Compensation Committee. Upon exercise of options, the option exercise price must be paid in full either in cash or by certified or bank check or other instrument acceptable to the Compensation Committee or, if the Compensation Committee so permits, by delivery of shares of Common Stock already owned by the optionee or, to the extent permitted by applicable law, by delivery of a promissory note. The exercise price may also be delivered to us by a broker pursuant to irrevocable instructions to the broker from the optionee.

At the discretion of the Compensation Committee, options granted under the Stock Incentive Plan may include a “re-load” feature pursuant to which an optionee exercising an option by the delivery of shares of Common Stock would automatically be granted an additional stock option (with an exercise price equal to the fair market value of the Common Stock on the date the additional stock option is granted) to purchase that number of shares of Common Stock equal to the number delivered to exercise the original stock option. The purpose of this feature is to enable participants to exercise options using previously owned shares of Common Stock while continuing to maintain their previous level of equity ownership in us.

The Compensation Committee may also grant stock appreciation rights, restricted stock, performance awards, tandem awards and other stock and non-stock-based awards under the Stock Incentive Plan. These awards will be subject to such conditions and restrictions as the Compensation Committee may determine, which may include the achievement of certain performance goals or continued employment with us through a specific period.

As of February 29, 2012, our manager, through an affiliate, had been granted options to purchase 7,836,227 shares, which were issued in connection with our equity offerings from 2002 through February 29, 2012. Portions of these options have been and may be assigned from time to time to employees of our manager or its affiliates. In addition, we may grant tandem options to our employees that correspond on a one-to-one basis with the options granted to our manager, such that exercise by an employee of the option would result in the corresponding option held by our manager being cancelled.

These manager options, which were granted to an affiliate of our manager in connection with the manager’s efforts related to our offerings, provide a means of performance-based compensation in order to provide an additional incentive for our manager to enhance the value of our Common Stock. We have no ownership interest in our manager. FOE I is the sole member of our manager. The beneficial owners of FOE I include Messrs. Wesley R. Edens, Peter L. Briger, Jr., Robert I. Kauffman, Randal A. Nardone and Michael E. Novogratz. As of February 29, 2012, Mr. Nardone was an executive officer of the Company.

The Stock Incentive Plan and the additional terms established by resolution of the board of directors provide for automatic annual awards of shares of our Common Stock valued at \$25,000, based on the closing price of our shares on the NYSE on the date of grant, to our non-officer or non-employee directors. In addition, each new independent member of our board of directors is granted an initial one-time grant of an option for 2,000 shares with an exercise price equal to fair market value on the date of grant.

## Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

For purposes of this filing, a “beneficial owner” means any person who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise has or shares:

- (i) voting power, which includes the power to vote, or to direct the voting of, shares of our Common Stock; and/or
- (ii) investment power, which includes the power to dispose, or to direct the disposition of, shares of our Common Stock.

A person is also deemed to be the beneficial owner of a security if that person has the right to acquire beneficial ownership of such security at any time within 60 days.

Listed in the following table and the notes thereto is certain information with respect to the beneficial ownership of shares of our Common Stock as of February 29, 2012, by each person known by us to be the beneficial owner of more than five percent of our Common Stock, and by each of our directors, director nominees and executive officers, both individually and as a group.

Name and Address of Beneficial Owner	Amount and Nature of Beneficial Ownership	Percent of Class <sup>(2)</sup>
Wesley R. Edens <sup>(3)(6)</sup> .....	5,644,191	5.2%
Kevin J. Finnerty <sup>(4)</sup> .....	297,353	* %
Stuart A. McFarland <sup>(4)</sup> .....	36,560	* %
David K. McKown <sup>(4)</sup> .....	36,560	* %
Alan L. Tyson <sup>(4)</sup> .....	2,973	* %
Kenneth M. Riis <sup>(4)</sup> .....	764,990	* %
Brian C. Sigman <sup>(4)</sup> .....	27,170	* %
Jonathan Ashley <sup>(4)</sup> .....	256,855	* %
Randal A. Nardone <sup>(5)(6)</sup> .....	4,704,786	4.3%
All directors, nominees and executive officers as a group	7,708,012	7.1%

\* Denotes less than 1%.

- (1) The address of FOE I and all officers and directors listed above are in the care of Fortress Investment Group LLC, 1345 Avenue of the Americas, 46<sup>th</sup> Floor, New York, New York 10105.
- (2) Percentage amount assumes the exercise by such persons of all options to acquire shares of our Common Stock that are exercisable within 60 days of February 29, 2012, and no exercise by any other person.
- (3) Includes 1,580,765 shares held by Mr. Edens, 1,025,729 shares and 3,037,697 shares issuable upon the exercise of options held by FOE I. Mr. Edens disclaims beneficial ownership of the shares held by FOE I and of the shares issuable upon the exercise of options held by FOE I except, in each case, to the extent of his pecuniary interest therein. Does not include 100,000 shares held by a charitable trust of which Mr. Edens’s spouse is sole trustee and Mr. Edens disclaims beneficial ownership of the shares held by this charitable trust; does not include 100,000 shares held by a charitable trust of which Mr. Edens is a trustee in respect of which, however, Mr. Edens disclaims beneficial ownership.
- (4) Includes with respect to each of these individuals the following number of shares issuable upon the exercise of options that are currently exercisable or exercisable within 60 days of February 29, 2012: Riis – 489,990; Sigman – 2,170; Ashley – 128,144; Finnerty – 2,000; McFarland – 4,000; McKown – 4,000; and Tyson – 2,000.
- (5) Includes 641,360 shares held by Mr. Nardone, 1,025,729 shares and 3,037,697 shares issuable upon the exercise of options held by FOE I. Mr. Nardone disclaims beneficial ownership of the shares held by FOE I and of the shares issuable upon the exercise of options held by FOE I except, in each case, to the extent of his pecuniary interest therein.
- (6) Mr. Edens and Mr. Nardone, as beneficial owners of FOE I, may be considered to have, together with the other beneficial owners of FOE I, shared voting and investment power with respect to the shares held by FOE I and the shares issuable upon the exercise of options held by FOE I.

### **Item 13. Certain Relationships and Related Transactions, Director Independence.**

In April 2006, we securitized a portfolio of subprime residential mortgage loans, which we refer to as “Subprime Portfolio I” and, through the related securitization trust (“Securitization Trust 2006”), entered into a servicing agreement with Nationstar Mortgage LLC (“Nationstar”, formerly known as Centex Home Equity Company, LLC), a subprime home equity mortgage lender to service this portfolio. In July 2006, private equity funds managed by an affiliate of our manager completed the acquisition of Nationstar. As compensation under the servicing agreement, Nationstar will receive, on a monthly basis, a net servicing fee equal to 0.50% per annum on the unpaid principal balance of the portfolio. In March 2007, we entered into a servicing agreement with Nationstar to service a second portfolio subprime residential mortgage loans (“Subprime Portfolio II”) under substantially the same terms through another securitization trust (“Securitization Trust 2007”). The outstanding unpaid principal balances of Subprime Portfolios I and II were approximately \$476.5 million and \$619.8 million at December 31, 2011, respectively.

In April 2010, we made a cash investment of \$75.0 million through two of our CDOs in a new real estate related loan to a portfolio company of a private equity fund managed by an affiliate of our manager. Our chairman is an officer of the borrower. This investment improves the applicable CDOs’ results under some of their respective tests, and is expected to yield approximately 22%. The loan will initially mature in April 2013, with two one-year extensions, and is secured by subordinated interests in the properties of the borrower. Interest on the loan will be accrued and deferred until maturity.

In January 2011, we made a cash investment of approximately \$47 million through two of our CDOs in a portion of a new secured loan to a portfolio company of a private equity fund managed by our manager. Our chairman and secretary are officers or directors of the borrower. The terms of the loan were negotiated by a third party bank who acted as agent for the creditors on the loan. At closing, we received an origination fee on the loan equal to 2% of the amount of cash it loaned to the portfolio company, which was the same fee received by other creditors on the loan. In February 2011, the portfolio company repaid the loan in full.

In December 2011, we made our first investment in excess mortgage servicing rights. We invested \$44 million to acquire a 65% interest in excess mortgage servicing rights of a \$9.9 billion residential mortgage portfolio. Nationstar, a leading residential mortgage servicer that is externally managed by our manager, is the servicer of the loans and invested alongside Newcastle by acquiring the remaining 35% interest in the excess mortgage servicing rights. To the extent any loans in this portfolio are refinanced by Nationstar, subject to certain limitations, we are entitled to receive our pro rata share of the excess mortgage servicing rights. Newcastle will not have any servicing duties, advance obligations or liabilities associated with the portfolio.

On March 6, 2012, we entered into definitive agreements to acquire an investment in excess MSR in connection with Nationstar’s acquisition of mortgage servicing assets from Aurora Bank FSB, a subsidiary of Lehman Brothers Bancorp Inc. We expect to invest approximately \$170 million to acquire an approximately 65% interest in the excess MSR on a portfolio of residential mortgage loans with an outstanding principal balance of approximately \$63 billion, comprised of approximately 75% non-conforming loans in private label securitizations and approximately 25% conforming loans in GSE pools. Nationstar will invest pari passu with us in approximately 35% of the excess MSR and will be the servicer of the loans performing all servicing and advancing functions, and retaining the ancillary income, servicing obligations and liabilities as the servicer. Under the terms of this investment, to the extent that any loans in the portfolio are refinanced by Nationstar, the resulting excess mortgage servicing rights will be shared pro rata by us and Nationstar, subject to certain limitations. The investment is expected to close in the second quarter of 2012 and is subject to regulatory and third-party approvals.

As of December 31, 2011, we held on our balance sheet total face amount investments of \$247.0 million in real estate securities and related loans issued by affiliates of our manager. We earned approximately \$22.5 million, \$22.2 million, and \$15.1 million of interest on such investments for the years ended December 31, 2011, 2010 and 2009, respectively.

In each instance described above, affiliates of our manager have an investment in the applicable affiliated fund and receive from the fund, in addition to management fees, incentive compensation if the fund’s aggregate investment returns exceed certain thresholds.

We are party to a management agreement with an affiliate of Fortress Investment Group LLC, pursuant to which our manager provides for the day-to-day management of our operations. The management agreement requires our manager to manage our business affairs in conformity with the policies and the investment guidelines that are approved and monitored by our board of directors. Our Chairman also serves as an officer of our manager.

The officers and directors of the Company review, approve and ratify transactions with related parties pursuant to the procedures outlined in the Company’s policy on related party transactions, which was formally adopted in February 2011. When considering potential transactions involving a related party that may require board approval, our officers notify our board of directors in writing of the proposed transaction, provide a brief background of the transaction and schedule a

meeting with the full board of directors to review the matter. At such meetings, our President, Chief Financial Officer and other members of management, as appropriate, provide information to the board of directors regarding the proposed transaction, after which the board of directors and management discuss the transaction and the implications of engaging a related party as opposed to an unrelated third party. If the board of directors (or specified directors as required by applicable legal requirements) determines that the transaction is in the best interests of the Company, it will vote to approve the Company's entering into the transaction with the applicable related party, which vote is evidenced by a written resolution of the board of directors.

FOE I is the sole member of FIG LLC, our manager. The beneficial owners of FOE I include Messrs. Wesley R. Edens, Peter L. Briger, Jr., Robert I. Kauffman, Randal A. Nardone and Michael E. Novogratz.

### **Determination of Director Independence**

At least a majority of the directors serving on the board of directors must be independent. For a director to be considered independent, our board of directors must determine that the director does not have any direct or indirect material relationship with the Company. The board of directors has established categorical standards to assist it in determining director independence, which conform to the independence requirements under the NYSE listing rules. Under the categorical standards, a director will be independent unless:

- (a) within the preceding three years: (i) the director was employed by the Company or its manager; (ii) an immediate family member of the director was employed by the Company or its manager as an executive officer; (iii) the director or an immediate family member of the director received more than \$120,000 per year in direct compensation from the Company, its manager or any controlled affiliate of its manager (other than director or committee fees and pension or other forms of deferred compensation for prior service (provided such compensation is not contingent on continued service)); (iv) the director was employed by or affiliated with the independent registered public accounting firm of the Company or its manager; (v) an immediate family member of the director was employed by the independent registered public accounting firm of the Company or its manager as a partner, principal or manager; or (vi) an executive officer of the Company or its manager was on the compensation committee of a company which employed the director, or which employed an immediate family member of the director as an executive officer; or
- (b) he or she is an executive officer of another company that does business with the Company and the annual sales to, or purchases from, the Company is the greater of \$1 million, or two percent of such other company's consolidated gross annual revenues.

Whether directors meet these categorical independence tests will be reviewed and will be made public annually prior to our annual meeting of stockholders. The board of directors may determine, in its discretion, that a director is not independent notwithstanding qualification under the categorical standards. The board of directors has determined that each of Messrs. Finnerty, McFarland, McKown and Tyson are independent for purposes of NYSE Rule 303A and each such director has no material relationship with the Company. In making such determination, the board of directors took into consideration, (i) in the case of Mr. Finnerty, that Mr. Finnerty is an independent director and stockholder of Newcastle Investment Holdings LLC (the predecessor of Newcastle), an entity managed by the Company's manager, and Mr. Finnerty received a loan in the amount of \$500,000 from each of Messrs. Edens and Nardone in 2009 and (ii) that certain directors have invested in the securities of private investment funds or companies managed by the Company's manager.

#### Item 14. Principal Accounting Fees and Services.

During the years ended 2011 and 2010, we engaged Ernst & Young LLP to provide us with audit and tax services. Services provided included the examination of annual financial statements, limited review of unaudited quarterly financial information, review and consultation regarding filings with the Securities and Exchange Commission and the Internal Revenue Service, assistance with management's evaluation of internal accounting controls, consultation on financial and tax accounting and reporting matters, and verification procedures as required by collateralized bond obligations. Fees for 2011 and 2010 were as follows:

<u>Year</u>	<u>Audit Fees</u>	<u>Audit-Related Fees</u>	<u>Tax-Related Fees</u>	<u>All Other Fees</u>
2011.....	\$ 1,858,100	—	\$ 181,162	—
2010.....	\$ 1,526,000	—	\$ 130,482	—

*Audit Fees.* Audit fees are fees billed for the consolidated financial statements, including the audit of internal control over financial reporting and the review of the Company's quarterly reports form 10-Q, as well as required audits of certain subsidiaries, consultation on audit related matters and required review of SEC filings.

*Audit-Related Fees.* Audit-related fees principally included attest services not required by statute or regulation.

*Tax Fees.* Tax fees for the years ended December 31, 2011 and 2010 related to tax planning and compliance and return preparation.

*All Other Fees.* None.

The Audit Committee has considered all services provided by the independent registered public accounting firm to us and concluded this involvement is compatible with maintaining the auditors' independence.

The Audit Committee is responsible for appointing the Company's independent registered public accounting firm and approving the terms of the independent registered public accounting firm's services. All engagements for services in 2010 were pre-approved by the Audit Committee. The Audit Committee has a policy requiring the pre-approval of all audit and permissible non-audit services to be provided by the independent registered public accounting firm.

## PART IV

### Item 15. Exhibits; Financial Statement Schedules.

- (a) and (c) Financial statements and schedules:  
See “Financial Statements and Supplementary Data.”
- (b) Exhibits filed with this Form 10-K:
  - 3.1 Articles of Amendment and Restatement (incorporated by reference to the Registrant’s Registration Statement on Form S-11 (File No. 333-90578), Exhibit 3.1).
  - 3.2 Articles Supplementary relating to the Series B Preferred Stock (incorporated by reference to the Registrant’s Quarterly Report on Form 10-Q for the period ended March 31, 2003, Exhibit 3.3).
  - 3.3 Articles Supplementary relating to the Series C Preferred Stock (incorporated by reference to the Registrant’s Report on Form 8-K, Exhibit 3.3, filed on October 25, 2005).
  - 3.4 Articles Supplementary relating to the Series D Preferred Stock (incorporated by reference to the Registrant’s Report on Form 8-A, Exhibit 3.1, filed on March 14, 2007).
  - 3.5 Amended and Restated By-laws (incorporated by reference to the Registrant’s Current Report on Form 8-K, Exhibit 3.1, filed on May 8, 2006).
  - 4.1 Rights Agreement between the Registrant and American Stock Transfer and Trust Company, as Rights Agent, dated October 16, 2002 (incorporated by reference to the Registrant’s Quarterly Report on Form 10-Q for the period ended September 30, 2003, Exhibit 4.1).
  - 4.2 Junior Subordinated Indenture between Newcastle Investment Corp. and The Bank of New York Mellon Trust Company, National Association, dated April 30, 2009 (incorporated by reference to the Registrant’s Report on Form 8-K, Exhibit 4.1, filed on May 4, 2009).
  - 4.3 Pledge and Security Agreement between Newcastle Investment Corp. and The Bank of New York Mellon Trust Company, National Association, as trustee, dated April 30, 2009 (incorporated by reference to the Registrant’s Report on Form 8-K, Exhibit 4.2, filed on May 4, 2009).
  - 4.4 Pledge, Security Agreement and Account Control Agreement among Newcastle Investment Corp., NIC TP LLC, as pledgor, and The Bank of New York Mellon Trust Company, National Association, as bank and trustee, dated April 30, 2009 (incorporated by reference to the Registrant’s Report on Form 8-K, Exhibit 4.3, filed on May 4, 2009).
  - 10.1 Amended and Restated Management and Advisory Agreement by and among the Registrant and FIG LLC (formerly known as Fortress Investment Group LLC), dated June 23 2003 (incorporated by reference to the Registrant’s Statement on Form S-11 (File No. 333-106135), Exhibit 10.1).
  - 10.2 Newcastle Investment Corp. Nonqualified Stock Option and Incentive Award Plan Amended and Restated Effective as of February 11, 2004 (incorporated by reference to the Registrant’s Annual Report on Form 10-K for the year ended December 31, 2005, Exhibit 10.2).
  - 10.3 Exchange Agreement between Newcastle Investment Corp. and Taberna Preferred Funding IV, Ltd., Taberna Preferred Funding V, Ltd., Taberna Preferred Funding VI, Ltd. and Taberna Preferred Funding VII, Ltd., dated April 30, 2009 (incorporated by reference to the Registrant’s Report on Form 8-K, Exhibit 10.1, filed on May 4, 2009).
  - 10.4 Exchange Agreement, dated as of January 29, 2010, by and among Newcastle Investment Corp., Taberna Capital Management, LLC, Taberna Preferred Funding IV, Ltd., Taberna Preferred Funding V, Ltd., Taberna Preferred Funding VI, Ltd. and Taberna Preferred Funding VII, Ltd. (incorporated by reference to the Registrant’s Report on Form 8-K, Exhibit 10.1, filed on February 2, 2010).
  - 10.5 Excess Servicing Spread Sale and Assignment Agreement between NIC MSR I LLC, a wholly owned subsidiary of Newcastle Investment Corp., and Nationstar Mortgage LLC, dated December 8, 2011.
  - 10.6 Excess Spread Refinanced Loan Replacement Agreement between NIC MSR I LLC, a wholly owned subsidiary of Newcastle Investment Corp., and Nationstar Mortgage LLC, dated December 8, 2011.
  - 12.1 Statements re: Computation of Ratios.
  - 21.1 Subsidiaries of the Registrant.
  - 23.1 Consent of Ernst & Young LLP, independent registered public accounting firm.
  - 31.1 Certification of Chief Executive Officer as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
  - 31.2 Certification of Chief Financial Officer as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

- 32.1 Certification of Chief Executive Officer 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 Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101.INS\* XBRL Instance Document.
- 101.SCH\* XBRL Taxonomy Extension Schema Document.
- 101.CAL\* XBRL Taxonomy Extension Calculation Linkbase Document.
- 101.DEF\* XBRL Taxonomy Extension Definition Linkbase Document.
- 101.LAB\* XBRL Taxonomy Extension Label Linkbase Document.
- 101.PRE\* XBRL Taxonomy Extension Presentation Linkbase Document.

\*XBRL (Extensible Business Reporting Language) information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15 (d) of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized:

NEWCASTLE INVESTMENT CORP.

By: /s/ Wesley R. Edens  
Wesley R. Edens  
Chairman of the Board

March 15, 2012

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this report has been signed below by the following person on behalf of the Registrant and in the capacities and on the dates indicated.

By: /s/ Kenneth M. Riis  
Kenneth M. Riis  
Director and Chief Executive Officer

March 15, 2012

By: /s/ Brian C. Sigman  
Brian C. Sigman  
Chief Financial Officer and Principal Accounting Officer

March 15, 2012

By: /s/ Kevin J. Finnerty  
Kevin J. Finnerty  
Director

March 15, 2012

By: /s/ Stuart A. McFarland  
Stuart A. McFarland  
Director

March 15, 2012

By: /s/ David K. McKown  
David K. McKown  
Director

March 15, 2012

By: /s/ Alan L. Tyson  
Alan L. Tyson  
Director

March 15, 2012

### **SPECIAL NOTE REGARDING EXHIBITS**

In reviewing the agreements included as exhibits to this Annual Report on Form 10-K, please remember they are included to provide you with information regarding their terms and are not intended to provide any other factual or disclosure information about the Company or the other parties to the agreements. The agreements contain representations and warranties by each of the parties to the applicable agreement. These representations and warranties have been made solely for the benefit of the other parties to the applicable agreement and:

- should not in all instances be treated as categorical statements of fact, but rather as a way of allocating the risk to the parties if those statements prove to be inaccurate;
- have been qualified by disclosures that were made to the other party in connection with the negotiation of the applicable agreement, which disclosures are not necessarily reflected in the agreement;
- may apply standards of materiality in a way that is different from what may be viewed as material to you or other investors; and
- were made only as of the date of the applicable agreement or such other date or dates as may be specified in the agreement and are subject to more recent developments.

Accordingly, these representations and warranties may not describe the actual state of affairs as of the date they were made or at any other time. Additional information about the Company may be found elsewhere in this Annual Report on Form 10-K and the Company's other public filings, which are available without charge through the SEC's website at <http://www.sec.gov>. See "Business – Corporate Governance and Internet Address; Where Readers Can Find Additional Information."

The Company acknowledges that, notwithstanding the inclusion of the foregoing cautionary statements, it is responsible for considering whether additional specific disclosures of material information regarding material contractual provisions are required to make the statements in this report not misleading.

## Exhibit Index

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- 10.2 Newcastle Investment Corp. Nonqualified Stock Option and Incentive Award Plan Amended and Restated Effective as of February 11, 2004 (incorporated by reference to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2005, Exhibit 10.2).
- 10.3 Exchange Agreement between Newcastle Investment Corp. and Taberna Preferred Funding IV, Ltd., Taberna Preferred Funding V, Ltd., Taberna Preferred Funding VI, Ltd. and Taberna Preferred Funding VII, Ltd., dated April 30, 2009 (incorporated by reference to the Registrant's Report on Form 8-K, Exhibit 10.1, filed on May 4, 2009).
- 10.4 Exchange Agreement, dated as of January 29, 2010, by and among Newcastle Investment Corp., Taberna Capital Management, LLC, Taberna Preferred Funding IV, Ltd., Taberna Preferred Funding V, Ltd., Taberna Preferred Funding VI, Ltd. and Taberna Preferred Funding VII, Ltd. (incorporated by reference to the Registrant's Report on Form 8-K, Exhibit 10.1, filed on February 2, 2010).
- 10.5 Excess Servicing Spread Sale and Assignment Agreement between NIC MSR I LLC, a wholly owned subsidiary of Newcastle Investment Corp., and Nationstar Mortgage LLC, dated December 8, 2011.
- 10.6 Excess Spread Refinanced Loan Replacement Agreement between NIC MSR I LLC, a wholly owned subsidiary of Newcastle Investment Corp., and Nationstar Mortgage LLC, dated December 8, 2011.
- 12.1 Statements re: Computation of Ratios.
- 21.1 Subsidiaries of the Registrant.
- 23.1 Consent of Ernst & Young LLP, independent registered public accounting firm.
- 31.1 Certification of Chief Executive Officer as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

- 32.1 Certification of Chief Executive Officer 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 Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
  
- 101.INS\* XBRL Instance Document.
- 101.SCH\* XBRL Taxonomy Extension Schema Document.
- 101.CAL\* XBRL Taxonomy Extension Calculation Linkbase Document.
- 101.DEF\* XBRL Taxonomy Extension Definition Linkbase Document.
- 101.LAB\* XBRL Taxonomy Extension Label Linkbase Document.
- 101.PRE\* XBRL Taxonomy Extension Presentation Linkbase Document.

\*XBRL (Extensible Business Reporting Language) information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934.

## Exhibit 12.1

### RATIO OF EARNINGS TO COMBINED FIXED CHARGES AND PREFERRED DIVIDENDS AND RATIO OF EARNINGS TO FIXED CHARGES

The following table sets forth our ratio of earnings to combined fixed charges and preferred dividends and our ratio of earnings to fixed charges for each of the periods indicated:

	Year Ended December 31,				
	<u>2011</u>	<u>2010</u>	<u>2009 (A)</u>	<u>2008 (B)</u>	<u>2007 (C)</u>
Ratio of Earnings to Combined Fixed Charges and Preferred Dividends	2.77	4.42	0.04	(8.32)	0.84
Ratio of Earnings to Fixed Charges	2.88	4.61	0.04	(8.68)	0.86

- (A) The 2009 deficiencies in each ratio are \$223.1 million and \$209.6 million, respectively. The 2009 results included impairment charges. Excluding such charges, the ratios would have exceeded 1 to 1.
- (B) The 2008 deficiencies in each ratio are \$2.99 billion and \$2.98 billion, respectively. The 2008 results included impairment charges. Excluding such charges, the ratios would have approximately equaled 1 to 1.
- (C) The 2007 deficiencies in each ratio are \$77.7 million and \$65.1 million, respectively. The 2007 results included impairment charges. Excluding such charges, the ratios would have exceeded 1 to 1.

For purposes of calculating the above ratios, (i) earnings represent "Income (loss) from continuing operations," excluding equity in earnings of unconsolidated subsidiaries, from our consolidated statements of operations, as adjusted for fixed charges and distributions from unconsolidated subsidiaries, and (ii) fixed charges represent "Interest expense" from our consolidated statements of operations. The ratios are based solely on historical financial information.

## Exhibit 21.1

### NEWCASTLE INVESTMENT CORP. SUBSIDIARIES

<u>Subsidiary</u>	<u>State/Country of Incorporation/Formation</u>
1. Dayton Asset Holding LLC	Delaware
2. DBNC Peach Holdings LLC	Delaware
3. DBNC Peach I Trust	Delaware
4. DBNC Peach LLC	Delaware
5. Fortress Asset Trust	Delaware
6. Impac CMB Trust 1998-C1	Delaware
7. Impac Commercial Assets Corporation	California
8. Impac Commercial Capital Corporation	California
9. Impac Commercial Holdings, Inc.	Maryland
10. Karl S.A.	Belgium
11. LIV Holdings LLC	Delaware
12. NCT Holdings II LLC	Delaware
13. NCT Holdings LLC	Delaware
14. Newcastle 2005-1 Asset Backed Note LLC	Delaware
15. Newcastle 2006-1 Asset Backed Note LLC	Delaware
16. Newcastle 2006-1 Depositor LLC	Delaware
17. Newcastle CDO IV Corp.	Delaware
18. Newcastle CDO IV Holdings LLC	Delaware
19. Newcastle CDO IV, Ltd.	Cayman Islands
20. Newcastle CDO V Corp.	Delaware
21. Newcastle CDO V Holdings LLC	Delaware
22. Newcastle CDO V, Ltd.	Cayman Islands
23. Newcastle CDO VI Corp.	Delaware
24. Newcastle CDO VI Holdings LLC	Delaware
25. Newcastle CDO VI, Ltd.	Cayman Islands
26. Newcastle CDO VII Corp.	Delaware
27. Newcastle CDO VII Holdings LLC	Delaware
28. Newcastle CDO VII, Limited	Cayman Islands
29. Newcastle CDO VIII 1, Limited	Cayman Islands
30. Newcastle CDO VIII 2, Limited	Cayman Islands
31. Newcastle CDO VIII Holdings LLC	Delaware
32. Newcastle CDO VIII LLC	Delaware
33. Newcastle CDO IX 1, Limited	Cayman Islands
34. Newcastle CDO IX 2, Limited	Cayman Islands
35. Newcastle CDO IX Holdings LLC	Delaware
36. Newcastle CDO IX LLC	Delaware
37. Newcastle CDO X Holdings LLC	Delaware
38. Newcastle CDO X Limited	Cayman Islands
39. Newcastle CDO X LLC	Delaware
40. Newcastle Foreign TRS Ltd.	Cayman Islands

Continued on next page.

## Exhibit 21.1

### NEWCASTLE INVESTMENT CORP. SUBSIDIARIES

<u>Subsidiary</u>	<u>State/Country of Incorporation/Formation</u>
41. Newcastle Investment Trust 2010-MH1	Delaware
42. Newcastle Investment Trust 2011-MH1	Delaware
43. Newcastle MH I LLC	Delaware
44. Newcastle Mortgage Securities LLC	Delaware
45. Newcastle Mortgage Securities Trust 2004-1	Delaware
46. Newcastle Mortgage Securities Trust 2006-1	Delaware
47. Newcastle Mortgage Securities Trust 2007-1	Delaware
48. Newcastle Trust I	Delaware
49. NIC Airport Corporate Center LLC	Delaware
50. NIC Apple Valley I LLC	Delaware
51. NIC Apple Valley II LLC	Delaware
52. NIC Apple Valley III LLC	Delaware
53. NIC CRA LLC	Delaware
54. NIC Dayton Town Center LLC	Delaware
55. NIC DB LLC	Delaware
56. NIC DP LLC	Delaware
57. NIC Management LLC	Delaware
58. NIC MSR I LLC	Delaware
59. NIC MSR II LLC	Delaware
60. NIC MSR LLC	Delaware
61. NIC OTC LLC	Delaware
62. NIC SF LLC	Delaware
63. NIC SN LLC	Delaware
64. NIC TP LLC	Delaware
65. NIC TRS Holdings, Inc.	Delaware
66. NIC TRS LLC	Delaware
67. NIC WL II LLC	Delaware
68. NIC WL LLC	Delaware
69. SP I Term Facility LLC	Delaware
70. SSL Term Loan LLC	Delaware
71. Steinhage B.V.	Netherlands
72. Xanadu Asset Holdings LLC	Delaware

## **EXHIBIT 23.1**

### **CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We consent to the incorporation by reference in the Registration Statement on Form S-3 (No. 333-172595) of Newcastle Investment Corp. and Subsidiaries and in the related Prospectus of our reports dated March 15, 2012, with respect to the consolidated financial statements of Newcastle Investment Corp. and Subsidiaries, and the effectiveness of internal control over financial reporting of Newcastle Investment Corp. and Subsidiaries, included in this Annual Report (Form 10-K) for the year ended December 31, 2011.

/s/ Ernst & Young LLP

New York, New York  
March 15, 2012

## EXHIBIT 31.1

### CERTIFICATION OF CHIEF EXECUTIVE OFFICER

I, Kenneth M. Riis, certify that:

1. I have reviewed this annual report on Form 10-K of Newcastle Investment Corp.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d – 15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d – 15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

March 15, 2012  
(Date)

/s/ Kenneth M. Riis  
Kenneth M. Riis  
Chief Executive Officer

## EXHIBIT 31.2

### CERTIFICATION OF CHIEF FINANCIAL OFFICER

I, Brian C. Sigman, certify that:

1. I have reviewed this annual report on Form 10-K of Newcastle Investment Corp.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d - 15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

March 15, 2012  
(Date)

/s/ Brian C. Sigman  
Brian C. Sigman  
Chief Financial Officer

**EXHIBIT 32.1**

**CERTIFICATION OF CEO PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report on Form 10-K of Newcastle Investment Corp. (the "Company") for the annual period ended December 31, 2011 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Kenneth M. Riis, as Chief Executive Officer of the Company, hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of his knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Kenneth M. Riis

Kenneth M. Riis

Chief Executive Officer

March 15, 2012

This certification accompanies the Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not, except to the extent required by the Sarbanes-Oxley Act of 2002, be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.

A signed original of this written statement required by Section 906 of the Sarbanes-Oxley Act of 2002 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

## EXHIBIT 32.2

### CERTIFICATION OF CFO PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report on Form 10-K of Newcastle Investment Corp. (the "Company") for the annual period ended December 31, 2011 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Brian C. Sigman, as Chief Financial Officer of the Company, hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of his knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Brian C. Sigman  
Brian C. Sigman  
Chief Financial Officer  
March 15, 2012

This certification accompanies the Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not, except to the extent required by the Sarbanes-Oxley Act of 2002, be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.

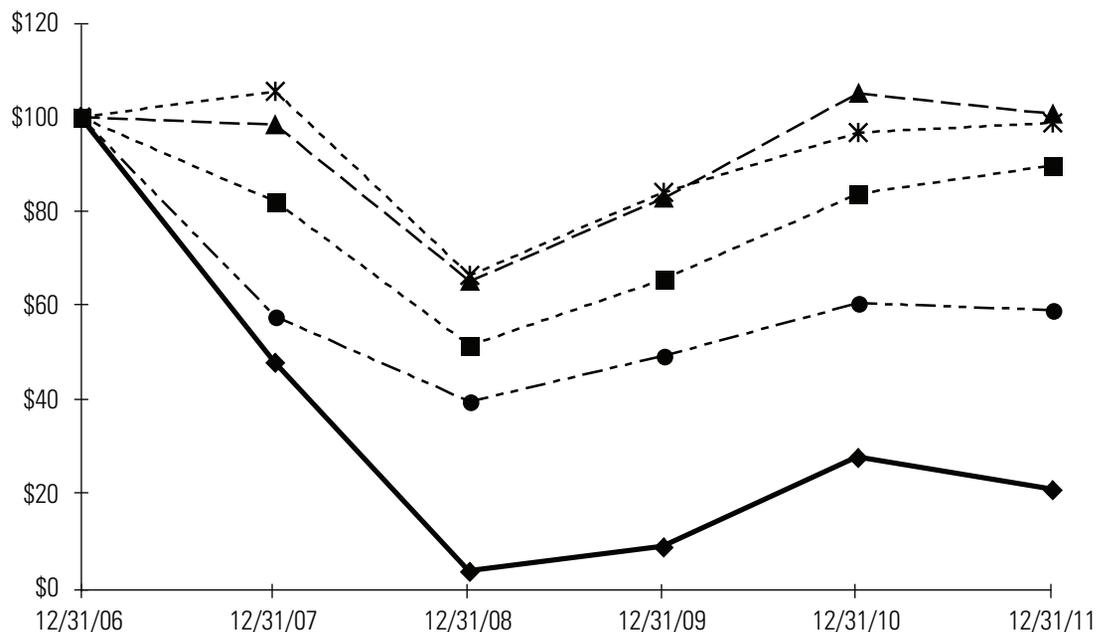
A signed original of this written statement required by Section 906 of the Sarbanes-Oxley Act of 2002 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

**End of Filing**

The following graph compares the cumulative total return for our common stock (stock price change plus reinvested dividends) with the comparable return of four indices: NAREIT All REIT, NAREIT Mortgage REIT, Russell 2000, and S&P 500. The graph assumes an investment of \$100 in the Company's common stock and in each of the indices on December 31, 2006 and that all dividends were reinvested. The past performance of our common stock is not an indication of future performance.

## NEWCASTLE INVESTMENT CORP.

### Stock Performance Chart



- ◆— Newcastle Investment Corp.
- ▲— Russell 2000
- \*— S&P 500
- NAREIT All REIT
- NAREIT Mortgage REIT

# Corporate Information

## Board of Directors

Wesley R. Edens  
Chairman of the Board  
Principal and Co-Chairman  
Fortress Investment Group LLC

Kevin J. Finnerty<sup>(1)</sup>  
Founding Partner  
Galton Capital Group

Stuart A. McFarland<sup>(1)</sup>  
Managing Partner  
Federal City Capital Advisors, LLC

David K. McKown<sup>(1)</sup>  
Senior Advisor  
Eaton Vance Management

Alan L. Tyson<sup>(1)</sup>  
Director

Kenneth M. Riis  
Managing Director  
FIG LLC

<sup>(1)</sup> Member of Audit Committee, Nominating and  
Corporate Governance Committee and  
Compensation Committee

## Corporate Officers

Kenneth M. Riis  
Chief Executive Officer and President

Jonathan Ashley  
Chief Operating Officer

Brian C. Sigman  
Chief Financial Officer

Randal A. Nardone  
Secretary

## Corporate Headquarters

Newcastle Investment Corp.  
c/o Fortress Investment Group LLC  
1345 Avenue of the Americas, 46th Floor  
New York, NY 10105  
(212) 798-6100  
[www.newcastleinv.com](http://www.newcastleinv.com)

## Independent Registered Public Accounting Firm

Ernst & Young LLP  
Five Times Square  
New York, NY 10036-6530

## Shareholder Services, Transfer Agent and Registrar

American Stock Transfer & Trust Company  
6201 15th Avenue  
Brooklyn, NY 11219  
(800) 937-5449

## Stock Exchange Listing

Newcastle Investment Corp.'s  
common stock is listed on the  
New York Stock Exchange (symbol: NCT)

## Investor Information Services

Newcastle Investment Corp.  
c/o Fortress Investment Group LLC  
1345 Avenue of the Americas, 46th Floor  
New York, NY 10105  
Tel: (212) 479-3195  
Fax: (212) 798-6060  
e-mail: [investorrelations@newcastleinv.com](mailto:investorrelations@newcastleinv.com)



**Newcastle Investment Corp.**  
1345 Avenue of the Americas  
46th Floor  
New York, NY 10105 USA  
(212) 798-6100  
[www.newcastleinv.com](http://www.newcastleinv.com)