

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 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, 2002

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: 001-13417

HANOVER CAPITAL MORTGAGE HOLDINGS, INC.
(Exact name of registrant as specified in its charter)

MARYLAND 13-3950486
(State or other Jurisdiction of (I.R.S. Employer Identification No.)
Incorporation or Organization)

379 THORNALL STREET, EDISON, NEW JERSEY 08837
(Address of principal executive offices) (Zip Code)

(732) 548-0101
(Registrant's telephone number, including area code)

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

Title of Class	Name of Exchange on Which Registered
----- Common Stock	-----
\$.01 Par Value per Share	American Stock Exchange

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K 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 an accelerated filer (as defined in Exchange Act Rule 12b-2) Yes No

The aggregate market value of the voting and non-voting common equity held by non-affiliates, based on the price at which the common equity was last sold as of June 30, 2002 was \$36,409,425.

The registrant had 4,534,402 shares of common stock outstanding as of March 25, 2003.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Notice of 2003 Annual Stockholders' Meeting and Proxy Statement, to be filed within 120 days after the end of registrant's fiscal year, are incorporated by reference into Part III.

HANOVER CAPITAL MORTGAGE HOLDINGS, INC.
FORM 10-K ANNUAL REPORT
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2002

INDEX

	PAGE
PART I	----
Item 1. Business	3
Item 2. Properties	16
Item 3. Legal Proceedings	16
Item 4. Submission of Matters to a Vote of Security Holders	16
PART II	
Item 5. Market for Registrant's Common Equity and Related Stockholder Matters	17
Item 6. Selected Financial Data	18
Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations	19
Item 7a. Quantitative and Qualitative Disclosure About Market Risk	36
Item 8. Financial Statements and Supplementary Data	38
Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	38
PART III	
Item 10. Directors and Executive Officers of the Registrant	39
Item 11. Executive Compensation	39
Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	39
Item 13. Certain Relationships and Related Transactions	39
Item 14. Controls and Procedures	39
PART IV	
Item 15. Exhibits, Financial Statement Schedules and Reports on Form 8-K	40
Signatures	41
Certifications	42

PART I

ITEM 1. BUSINESS

This Annual Report on Form 10-K contains, in addition to historical information, forward-looking statements that involve risk and uncertainty. Our actual results could differ significantly from the results discussed in the forward-looking statements. Factors that could cause or contribute to such differences include those discussed in "Management's Discussion and Analysis of Financial Condition and Results of Operations," as well as those discussed elsewhere in this Annual Report on Form 10-K.

GENERAL

Hanover Capital Mortgage Holdings, Inc., which we refer to as Hanover, was incorporated in Maryland on June 10, 1997. Hanover is a specialty finance company organized as a real estate investment trust, or REIT, pursuant to the Internal Revenue Code of 1986, as amended, which we refer to as the "Code." Hanover has two primary subsidiaries: Hanover Capital Partners Ltd., which we refer to as HCP, and HanoverTrade, Inc., which we refer to as HT. When we use the terms "we", "us", "our" or "the Company," we are referring to Hanover together with its consolidated and unconsolidated subsidiaries including HCP and HT.

We are engaged in three principal businesses, which are conducted through our three primary operating units: Hanover, HCP and HT. Hanover's principal business strategy is to invest in subordinate mortgage-backed securities, which we refer to as MBS, and mortgage loans for its own account, and, since 2001, for third parties. HCP's principal business strategy is to generate consulting and other fee income by providing consulting and due diligence services, focusing on loan sale advisory, loan file due diligence reviews, staffing solutions and mortgage assignment and collateral rectification services. HT's principal business strategy is to generate fee income by operating an Internet exchange for trading mortgage loans, mortgage servicing rights and related assets, and providing state-of-the-art technologies supported by experienced valuation, operations and trading professionals. As discussed below, on July 1, 2002, Hanover acquired 100% of the ownership interests in HCP and HT. We believe that our new consolidated financial reporting should also include segment information for each of Hanover, HCP and HT on a stand-alone basis. Note 16 to the consolidated financial statements attached to this Annual Report on Form 10-K includes financial information for each of our segments on a stand-alone basis.

Our principal business objective is to generate net interest income on our portfolio of mortgage securities and mortgage loans and to generate fee income through HCP, HT and third party asset-management contracts.

Our principal executive offices are located at 379 Thornall Street, Edison, New Jersey 08837.

CONSOLIDATION OF HANOVER, HCP AND HT

Pursuant to a Stock Purchase Agreement effective July 1, 2002 and approved by a special committee of disinterested members of our Board of Directors, Hanover acquired 100% of the outstanding common stock of each of HT, HCP and Hanover Capital Partners 2, Inc., which we refer to as HCP-2, a previously inactive subsidiary. Hanover had previously owned 100% of the non-voting preferred stock, but none of the voting common stock, of each of HT, HCP and HCP-2. This ownership structure was established in order to satisfy tax laws governing Hanover's status as a REIT. Changes in the tax laws made it possible for Hanover to acquire voting control of HT, HCP and HCP-2 and operate under new rules permitting REITs to wholly own subsidiaries such as HT, HCP and HCP-2. Therefore, as of July 1, 2002, Hanover owns 100% of the outstanding capital stock of each of HT, HCP and HCP-2, and for periods ending after June 30, 2002, Hanover's financial statements will be consolidated with the financial statements of HT, HCP and HCP-2.

Hanover acquired the common shares of HT, HCP and HCP-2 from four of its directors who are also executive officers for \$474,000, the price set by an independent appraiser.

HANOVER

General

Hanover's primary businesses are (1) to acquire and hold prime whole single-family mortgage loans which serve as collateral for collateralized mortgage obligations, which we refer to as CMOs, as well as subordinated single-family mortgage securities and other mortgage-related assets and (2) to generate fee income from its operating subsidiaries. "Subordinated" MBS bear all of the credit losses on the related pool of mortgage loans. In other words, any declines in the value of the pool of loans will erode the value of our subordinate interests before any losses accrue to the value of more senior interests in the pool. As a result, these securities bear much greater risk than the more senior tranches and are generally rated below investment grade by the major statistical rating organizations, such as Moody's Investors Service, Standard & Poor's Ratings Group or Fitch Investor Service.

We also act as an outside management company for real estate investment vehicles. In this capacity, we provide asset-management services, including due diligence and administrative responsibilities. Currently, we manage the investments of HDMF-I LLC, an entity that invests in sub- and non-performing single-family mortgage loans. Our primary objectives in forming HDMF-I were to earn a profit participation while also earning fee income from the related asset management contract. As of December 31, 2002, HDMF-I had received capital commitments of \$18,500,000, including \$5,820,000 committed by us. We are currently negotiating with institutional investors to increase the total capital commitments to HDMF-I, and we also intend to target other opportunities for us to manage assets for third parties under a similar structure; however, there can be no assurances that we will be successful in raising additional funds to manage.

We believe that our sales and due diligence organization and mortgage industry expertise give us advantages over other mortgage market participants. Prior to acquiring any subordinate MBS, we use our own resources and information provided by HCP to analyze the credit risk characteristics of these mortgage loan pools and, we believe, to price these securities more accurately than others in the market.

In the past, we invested directly in mortgage loans on our own behalf. We issued MBS secured by these loans, and retained the subordinate securities from these transactions. Although we may securitize additional pools of mortgage loans on our own in the future, our current strategy is to acquire and hold prime whole single-family mortgage loans which serve as collateral for CMOs, as well as subordinated single-family mortgage securities and other mortgage-related assets.

Trends and Recent Developments

Purchase and Sale of Subordinate MBS. As mentioned above, prior to 1999 we invested primarily in prime mortgage whole loans, which we subsequently securitized. When we securitized these mortgage whole loans, we retained a subordinate interest in the loans, which are referred to as subordinate MBS. Other issuers also create subordinate MBS that trade in organized markets. The market for subordinate MBS changed dramatically at the end of 1998 and in early 1999, resulting in a substantial buying opportunity for us. As a result of the change in relative pricing, we found that we could purchase subordinate MBS created by other entities at very attractive yields. Our costs to acquire subordinate MBS created by other issuers is substantially lower than the cost of creating our own subordinate MBS. As a result of the continued evolution of the markets in which we operate, we shifted our strategy in 1999 from a focus on securitizing seasoned mortgage whole loans to acquiring interests in third-party securitizations.

During 2002, we purchased thirty-seven subordinate MBS with an aggregate principal balance of \$23,255,000 at a net purchase price of \$12,909,000 and we sold twenty-four subordinate MBS with an aggregate principal balance of \$16,322,000 at a net sales price of \$13,777,000. The sale of subordinate MBS during 2002 was primarily in response to market conditions and, to a lesser extent, asset performance. However, given that we generally intend to hold our assets for the long-term, we do not anticipate that the sale of subordinate MBS will be a recurring source of income for us.

During 2002, we purchased MBS issued by agencies of the Federal Government, which we refer to as agency-issued MBS, with an aggregate principal balance of \$29,994,000 at a net purchase price of \$33,243,000. During 2002, we sold agency-issued MBS with an aggregate principal balance of \$53,376,000 at a net sales price of \$58,867,000. In the third quarter of 2002, we terminated our agency-issued MBS trading activity.

Current Portfolio Composition

At December 31, 2002, we had invested \$112,969,000, or 72.5% of our total assets, in single-family mortgage loans classified as held for sale and collateral for CMOs, and \$14,098,000, or 9.0%, of our total assets, in single-family MBS classified as available for sale, held to maturity or trading. The composition of mortgage loans and mortgage securities is described in detail in Notes 3 and 4 to our audited consolidated financial statements included in this Annual Report on Form 10-K.

In 2002, we experienced \$347,000 of mortgage loan losses on our mortgage loan portfolio (held for sale and collateral for CMOs), and \$48,000 of losses on our MBS portfolio (available for sale, held to maturity and trading). We experienced \$149,000 of mortgage loan losses during 2001 on our mortgage loan portfolio and \$90,000 of losses on our MBS portfolio. We recorded a provision for anticipated credit losses of \$393,000 and \$709,000 in 2002 and 2001, respectively.

Generally, we intend to hold the mortgage loans and created mortgage securities on a long-term basis, so that we will earn returns over the lives of the mortgage loans and mortgage securities rather than from sales of the investments. However, we may sell mortgage securities from time to time depending on market conditions.

Securitization Activity

In June 2000, we issued \$13,222,000 of CMO borrowings at a discount of \$2,013,000 for net proceeds before expenses of \$11,209,000. The "Hanover 2000-A" CMO securities carry a fixed interest rate of 6.50%. The Hanover 2000-A securities were collateralized by \$25,588,000 principal balance of the retained portions of our previous CMO borrowings, Hanover 98-A, Hanover 99-A and Hanover 99-B and certain retained MBS from Hanover 98-B at time of securitization.

Subordinate MBS Purchases

In analyzing subordinate MBS for purchase, we focus primarily on subordinated interests, which we refer to as tranches, in pools of prime whole single-family mortgage loans that do not fit into large conduits sponsored by government agencies such as the Federal National Mortgage Association ("FNMA" or "Fannie Mae"), the Federal Home Loan Mortgage Corporation ("FHLMC"), or the Government National Mortgage Association ("GNMA" or "Ginnie Mae"). Typically, loans fail to qualify for these programs because the principal balance of the mortgages exceeds the maximum amount permissible in a government agency guaranteed MBS.

The subordinate interests that we purchase are generally structured so that they will absorb the credit losses resulting from a specified pool of mortgages. Because these tranches could potentially absorb credit losses, the securities we purchase are generally either not rated or are rated below investment grade (generally "BB" or "B"), although the pools are usually collateralized by "A" quality mortgages originated by several of the largest non-government mortgage conduits in the market. These tranches are generally purchased at a substantial discount to their principal balance. This discount provides a cushion against potential future losses and, to the extent that losses on the mortgage loans are less than the discount, the discount provides a yield enhancement. A majority of our subordinate MBS acquired to date have paid interest at fixed rates.

We purchase subordinate MBS primarily from "Wall Street" dealer firms, although we are also attempting to develop direct relationships with the larger issuers of subordinate MBS. For the foreseeable future, we believe that there will be an adequate supply of subordinate MBS available in the market.

As of December 31, 2002, we had purchased since inception approximately \$104,001,000 (principal balance) of subordinate MBS from third parties at an aggregate purchase price of \$53,649,000. As of the same date, we had sold approximately \$79,134,000 (principal balance) of such securities. At December 31, 2002, we owned \$23,026,000 (principal balance) of subordinate MBS purchased from third parties, representing a subordinate interest in \$5,756,230,000 of single-family mortgage loan pools. The aggregate carrying value of these MBS at December 31, 2002 was \$12,966,000.

We are not dependent on any one source for subordinate MBS investments because there are a number of regular issuers of such securities. Note 5 to our audited consolidated financial statements included in this Annual Report on Form 10-K describes the concentration of our portfolio by issuer. Management believes that the loss of any single financial institution from which we purchase subordinate MBS would not have any detrimental effect on us. However, we cannot assure you that increased competition will not have a negative effect on the pricing of such investments.

HCP has a due diligence and consulting staff, located in Edison, New Jersey, consisting of approximately 19 full-time employees at December 31, 2002 and access to a part-time pool of employees in excess of 500. The due diligence staff contributes to the process of selecting and acquiring subordinate MBS by providing expertise in the analysis of many characteristics of the underlying single-family mortgage loans. Before we offer to purchase a subordinate MBS, HCP employees conduct an extensive investigation and evaluation of the loans collateralizing the security. This examination typically consists of analyzing the information made available by the seller, reviewing other relevant material that may be available, analyzing the underlying collateral (including reviewing our single-family mortgage loan database which contains, among other things, listings of property values and loan loss experience in local markets for

similar assets) and, in certain instances, obtaining property-specific opinions of value from third parties. Our senior management determines the amount to be offered for the security using a proprietary stratification and pricing system which focuses on, among other things, rate, term, location, credit scores and types of the loans. We also review information on the local economy and real estate markets (including the amount of time and procedures legally required to foreclose on real property) where the loan collateral is located.

By examining the mortgage pool loan data, we estimate a prepayment speed based primarily upon the gross coupon rates and seasoning of the subject pool. We also determine a "base case" default scenario and several alternative scenarios based on the Public Securities Association's standard default assumption, which we refer to as SDA. The default scenarios reflect our estimate of the most likely range of potential losses on the underlying mortgage loans, taking into consideration the credit analysis described above.

After determination of a prepayment speed and a base case SDA, we model the pools' cash flow stream and calculate a proposed purchase price as the present value of the base case cash flow stream, discounted by the current market rate for securities with similar product type and credit characteristics. We then examine the yield of the security under various alternative SDAs and prepayment assumptions and, if necessary, adjust the proposed purchase price so that we will receive an acceptable yield under a variety of possible scenarios.

HANOVER CAPITAL PARTNERS LTD.

Through HCP, we provide due diligence and consulting services for commercial banks, government agencies, mortgage banks, credit unions and insurance companies. The operations consist of loan sale advisory assignments, the underwriting of credit, analysis of loan documentation and collateral, analysis of the accuracy of the accounting for mortgage loans serviced by third party servicers, and the preparation of documentation to facilitate the transfer of mortgage loans. The due diligence analyses are performed on a loan-by-loan basis. Consulting services include loan sale advisory work for governmental agencies such as the Small Business Administration and the Federal Deposit Insurance Corporation as well as private sector financial institutions. HCP also performs due diligence on mortgage assets we acquire, and owns a licensed mortgage banker, Hanover Capital Mortgage Corporation, which we refer to as HCMC and a licensed broker-dealer, Hanover Capital Securities, Inc., which we refer to as HCS. Neither of these companies currently conducts any material ongoing business.

In January 2000, HCP hired all of the former management of Document Management Network, Inc., to continue as the Assignment Division of HCP. The Assignment Division provides mortgage assignment services for many of the customers serviced by HCP. Whenever an institution purchases a mortgage loan in the secondary market, the purchaser is required to submit paperwork (called an "assignment of mortgage") to the local county or city jurisdiction in which the mortgaged property is located in order to record the new institution's interest in the mortgaged property. The Assignment Division employees prepare and process this paperwork for third party institutions.

During 2002, HCP's assignment and due diligence fees accounted for 27% of our total consolidated revenues. For the year ended December 31, 2002, three of HCP's customers accounted for 49% in the aggregate of its total revenue.

HANOVERTRADE, INC.

Through HT, we conduct loan brokering and trading, and loan sale advisory services. HT operates an Internet exchange for trading mortgage loans, mortgage servicing rights and related assets, and performs loan sale advisory services for third parties. HT was incorporated on May 28, 1999. In the third quarter of 2000, the loan brokering and trading activities of HCP were combined with the HT activities. HT officially launched its web site on October 29, 2000.

In January 2001, HT hired all of the former employees and acquired all of the assets of Pamex Capital Partners, LLC. Prior to its acquisition, Pamex was a traditional broker of pools of mortgage loans and consumer loans. With the acquisition of Pamex, subsequent reassignments and new hires, at December 31, 2002, HT had 11 full-time salespeople. These salespeople attempt to maintain regular contact with all of the major buyers and sellers of mortgage and consumer prime whole loans.

HT facilitates the sale of pools of mortgage loans, consumer loans and commercial mortgage loans to institutional purchasers. HT arranges for such sales through its web site as well as through more traditional channels, including telephone contact and e-mail. To assist in the sales process of these pools, HT may prepare marketing materials and marketing analyses for sellers of pools.

During 2002, HT's loan brokering, trading and advisory services, taken together, accounted for 17% of our total consolidated revenues. In that year, two of HT's customers individually accounted for 66% and 24% of HT's total accounts receivable, and one customer accounted for 49% of HT's total revenues. HT's contract with the Federal Deposit Insurance Corporation, which was the customer contributing 49% of HT's total revenues, ended in April 2002. Although the FDIC from time to time retains HT to perform additional advisory services related to that original contract, we cannot assure you that HT will be able to obtain additional engagements that will maintain the level of revenues generated by the FDIC contract.

FINANCING

General

Until we can arrange for long-term financing, we initially finance purchases of mortgage-related assets with equity and short-term borrowings through reverse repurchase agreements. Generally, upon repayment of each borrowing in the form of a reverse repurchase agreement, the mortgage asset used to secure the financing will immediately be pledged to secure a new reverse repurchase agreement or some form of long-term financing. At December 31, 2002, we had one established committed reverse repurchase agreement line of credit with available capacity to borrow \$10 million. In addition, we had four uncommitted reverse repurchase agreement lines of credit.

Reverse Repurchase Agreements

A reverse repurchase agreement, although structured as a sale and repurchase obligation, is a financing transaction in which we pledge our mortgage assets as collateral to secure a short-term loan. Generally, the other party to the agreement will loan an amount equal to a percentage of the market value of the pledged collateral, ranging from 50% to 97% depending on the credit quality, liquidity and price volatility of the collateral pledged. At the maturity of the reverse repurchase agreement, we repay the loan and reclaim our collateral. Under reverse repurchase agreements, we generally retain the incidents of beneficial ownership, including the right to distributions on the collateral and the right to vote on matters as to which certificate holders vote. If we default on a payment obligation under such agreements, the lending party may liquidate the collateral.

Some of our reverse repurchase agreements may qualify for special treatment under the United States Bankruptcy Code in the event we become bankrupt or insolvent, which permits the creditor to avoid the automatic stay provisions of the Bankruptcy Code and to foreclose on the collateral without delay. In the event of the insolvency or bankruptcy of a lender during the term of a reverse repurchase agreement, the lender may be permitted, under the Bankruptcy Code, to repudiate the contract, and our claim against the lender for damages may be treated as that of an unsecured creditor. In addition, if the lender is a broker or dealer subject to the Securities Investor Protection Act of 1970 or an insured depository institution subject to the Federal Deposit Insurance Act, our ability to exercise our rights to recover our mortgage assets under a reverse repurchase agreement or to be compensated for damages resulting from the lender's insolvency may be limited by those laws. The effect of these various statutes is, among other things, that a bankrupt lender, or its conservator or receiver, may be permitted to repudiate or disaffirm its reverse repurchase agreements, and our claim against the bankrupt lender may be treated as an unsecured claim. Should this occur, our claims would be subject to significant delay and, if and when paid, could be in an amount substantially less than the damages we actually suffered.

To reduce our exposure to the credit risk of reverse repurchase agreements, we enter into such arrangements with several different parties. We monitor our exposure to the financial condition of our reverse repurchase lenders on a regular basis, including the percentage of our mortgage securities that are the subject of reverse repurchase agreements with a single lender. Notwithstanding these measures, we cannot assure you that we will be able to avoid such third party risks.

Our reverse repurchase borrowings bear short-term (one year or less) fixed interest rates indexed to LIBOR plus a spread of 40 to 200 basis points depending on the credit of the related mortgage assets. In the event the market value of existing collateral declines, which could occur in dramatically rising interest-rate markets, we could be required to pledge additional collateral to the loan, or to sell assets to reduce the borrowings.

CAPITAL ALLOCATION GUIDELINES (CAG)

We have adopted capital allocation guidelines, which we refer to as CAG, to strike a balance in our ratio of debt to equity. Modifications to the CAG require the approval of a majority of our Board of Directors. The CAG are intended to keep our leverage balanced by (i) matching the amount of leverage to the riskiness (return and liquidity) of each investment and (ii) monitoring the credit and prepayment performance of each investment to adjust the required capital. This analysis takes into account our various hedging and other risk containment programs discussed below.

Lenders generally require us to deduct a minimum fixed percentage from the mortgage asset to determine the value of the asset for lending purposes. There is some variation in haircut levels among lenders from time to time. From the lender's perspective, the haircut is a cushion to provide additional protection if the value of or cash flow from an asset pool declines. The size of the haircut depends on the liquidity and price volatility of each investment. Agency-issued securities are very liquid, with price volatility in line with the fixed income markets, which means a lender requires a smaller haircut, typically 3%. On the other extreme, securities rated below "AAA" and securities not registered with the Securities and Exchange Commission are substantially less liquid, and have more price volatility than agency-issued securities, which results in a lender requiring a larger haircut (5% to 50% depending on the rating). Particular securities that are performing below expectations would also typically require a larger haircut. The haircut for residential whole loan pools will generally range between 3% and 5% depending on the documentation and delinquency characteristics of the pool. Certain whole loan pools may have haircuts which may be negotiated with lenders in excess of 5% due to other attributes of the pool, including delinquencies, aging and liens.

Implementation of the CAG -- Mark to Market Accounting

Each quarter, for financial management and accounting purposes, we undertake a valuation activity known as "mark to market." This process consists of (i) valuing our investments acquired in the secondary market, and (ii) valuing our non-security investments, such as retained interests in securitizations. To value our investments acquired in the secondary market, we obtain benchmark market quotes from traders who make markets in securities similar in nature to our investments. We then adjust for the difference in pricing between securities and whole loan pools. We calculate the market values of our retained interests in securitizations using market assumptions for losses, prepayments and discount rates.

We subtract the face amount of the financing used for the securities and retained interests from the current market value of the mortgage assets to obtain the current market value of our equity positions. We then compare this value to the required capital as determined by our CAG. If our actual equity falls below the capital required by our guidelines, we must prepare a plan to bring the actual capital above the level required.

Periodically, management presents to the Board of Directors the results of the CAG compared to actual equity. Management may propose changing the capital required for a class of investments or for an individual investment based on its prepayment and credit performance relative to the market and our ability to predict or hedge the risk of the investments.

As a result of these procedures, the leverage of the balance sheet will change with the performance of our investments. Good credit or prepayment performance may release equity for purchase of additional investments. Poor credit or prepayment performance may cause additional equity to be allocated to existing investments, forcing a reduction in investments on the balance sheet. In either case, the periodic performance evaluation, along with the corresponding leverage adjustments, is intended to help maintain the maximum acceptable leverage (and earnings) while protecting our capital base. We can give you no assurance that the CAG will successfully protect our capital.

RISK MANAGEMENT

We believe that our portfolio income is subject to three primary risks: credit risk, interest rate risk and prepayment risk. Although we believe we have developed a cost-effective asset/liability management program to provide a level of protection against credit, interest rate and prepayment risks, no strategy can completely insulate us from the effects of credit risk, interest rate changes, prepayments and defaults by counterparties. Further, certain of the Federal income tax requirements that we must satisfy to qualify as a REIT may limit our ability to fully hedge our risks.

Credit Risk Management

We attempt to reduce credit risk by (i) reviewing each MBS or mortgage loan prior to purchase to ensure that it meets our guidelines; (ii) employing early intervention, aggressive collection and loss mitigation techniques; (iii) maintaining appropriate capital and reserve levels; and (iv) obtaining representations and warranties, to the extent possible, from originators. Although we do not set specific geographic diversification requirements, we monitor the geographic dispersion of the mortgage loans and make decisions on a portfolio-by-portfolio basis about adding to specific concentrations. By diversifying our portfolio across geographic regions, we mitigate the negative effects on our portfolio of adverse economic conditions in particular regions.

In the past, we invested directly in mortgage loans on our own behalf. We generally purchased prime single-family mortgage loans in bulk pools of \$2 million to \$100 million. The credit underwriting process varied depending on the pool characteristics, including seasoning, loan-to-value ratios and payment histories. For a new pool of single-family mortgage loans, a full due diligence review was undertaken, including a review of the documentation, appraisal reports and credit underwriting. Where required, an updated property valuation was obtained. The bulk of the work was performed by employees in the due diligence operations of HCP. Depending on market conditions, we might decide to undertake this business activity again in the future.

Interest Rate Risk Management

We generally attempt to hedge interest rate risks associated with all our investments, other than assets held as collateral for CMOs. Our primary method of addressing interest rate risk on our mortgage loans is by securitizing mortgage loans with CMOs or through real estate mortgage investment conduits, or "REMICs", both of which are designed to provide long-term financing while maintaining a consistent spread in a variety of interest-rate environments. As a result, we believe that our primary interest rate risk relates to fixed-rate MBS and mortgage loans that we finance with reverse repurchase agreements.

A variety of hedging instruments may be used, depending on the asset or liability to be hedged and the relative price of the various hedging instruments. Possible hedging instruments include forward sales of mortgage securities, interest rate futures or options, interest rate swaps, and caps and floor agreements. Mortgage loans held as collateral for CMOs are generally financed in a manner intended to maintain a consistent spread in a variety of interest rate environments and therefore are not hedged.

In particular, we may purchase interest rate caps, interest rate swaps and similar instruments to attempt to mitigate the risk of the cost of our variable rate liabilities increasing at a faster rate than the earnings on our mortgage assets during a period of rising interest rates. Subject to compliance with Federal income tax laws limiting the operations of a REIT, we generally hedge as much of the interest rate risk as management determines is reasonable, given the cost of such hedging transactions and other factors.

As discussed above, we may use a variety of instruments in our hedging program. Two examples of strategies we currently use are interest rate caps and short sales of so-called "TBA" securities. In a typical interest rate cap agreement, the cap purchaser makes an initial lump sum cash payment to the cap seller in exchange for the seller's promise to make cash payments to the purchaser on fixed dates during the

contract term if prevailing interest rates exceed the rate specified in the contract. We enter into interest rate hedge mechanisms (interest rate caps) to manage our interest rate exposure on certain reverse repurchase financing. "TBA" securities (which stands for "to be announced") are commitments to deliver mortgage securities which have not yet been created. When we sell a TBA security short, we ordinarily cover the short sale within a month by agreeing to buy a similar TBA security. We then sell another TBA security and cover that sale in the following month and so on. The changes in market prices from such short sales are intended to offset changes in interest rates that could offset either the market price or the net interest margin earned on our mortgage securities. We may also use, but as yet have not used, mortgage derivative securities. Mortgage derivative securities can be used as effective hedging instruments in certain situations as the value and yields of some of these instruments tend to increase as interest rates rise and to decrease as interest rates decline. We will limit our purchases of mortgage derivative securities to investments that meet REIT requirements. To a lesser extent, we may also enter into, but again have not entered into, interest rate swap agreements, financial futures contracts and options on financial futures contracts, and forward contracts. However, we will not invest in these instruments unless we can do so without falling under the registration requirements of the Commodity Exchange Act or otherwise violating the provisions of that Act. The REIT rules may restrict our ability to purchase certain instruments and employ other strategies. In all our hedging transactions, we deal only with counterparties that we believe are sound credit risks.

- - Costs and Limitations

We believe that we have implemented a cost-effective hedging policy to provide an adequate level of protection against interest rate risks. However, maintaining an effective hedging strategy is complex, and no hedging strategy can completely insulate us from interest rate risks. Moreover, as noted above, certain REIT rules may limit our ability to fully hedge our interest rate risks. We monitor carefully, and may have to limit, hedging strategies to assure that we do not violate REIT rules, which could result in disqualification and/or payment of penalties.

In addition, hedging involves transaction and other costs, which can increase dramatically as the period covered by the hedge increases and also can increase in periods of rising and fluctuating interest rates. Therefore, we may be prevented from effectively hedging interest rate risks without significantly reducing our return on equity.

Prepayment Risk Management

Our senior management monitors prepayment risk through periodic reviews of the impact of a variety of prepayment scenarios on our revenues, net earnings, dividends, cash flow and net balance sheet market value.

REGULATION

Although HCMC does not currently originate mortgage loans, HCMC continues to service one loan. In addition, HCMC's activities are subject to the rules and regulations of HUD. Mortgage operations also may be subject to applicable state usury and collection statutes.

HCS is a registered broker/dealer with the Securities and Exchange Commission. During 2002, Pamex Securities, LLC, a wholly-owned subsidiary of HanoverTrade, Inc, withdrew from the Securities and Exchange Commission as a registered broker/dealer.

COMPETITION

We compete with a variety of institutional investors for the acquisition of mortgage-related assets that we deem attractive. These investors include other REITs, investment banking firms, savings and loan associations, insurance companies, mutual funds, pension funds, banks and other financial institutions that invest in mortgage-related assets and other investment assets. Many of these investors have greater financial resources and access to lower costs of capital than we do. While there is generally a broad supply of liquid mortgage securities for companies like us to purchase, we cannot assure you that we will always be successful in acquiring mortgage-related assets that we deem most suitable for us, because of the number of other investors competing for the purchase of these securities.

EMPLOYEES

We had 57 employees at December 31, 2002 with 9, 19 and 29 employees devoting their time to Hanover, HCP and HT, respectively. Hanover engages the services of HCP to provide management expertise, product sourcing, due diligence support, and general and administrative services to assist Hanover in accomplishing its business objectives. HCP periodically hires additional individuals on a temporary basis for due diligence and consulting engagements from a pool of approximately 500 individuals. To date, we believe we have been successful in our efforts to recruit qualified employees, but there is no assurance that we will continue to be successful in the future. None of the employees are subject to collective bargaining agreements.

TRADEMARKS

HCP owns two trademarks that have been registered with the United States Patent and Trademark Office, one which expires in the year 2003 and the other expires in 2004. HT owns one registered trademark which expires in 2007, has one trademark pending and is in the process of registering one trademark with the United States Patent and Trademark Office. HT also filed a patent application in 2001 in connection with its trading web site and approval of the patent is pending.

FUTURE REVISIONS IN POLICIES AND STRATEGIES

The Board of Directors has established Hanover's investment and operating policies, which can be revised only with the approval of the Board of Directors, including a majority of the unaffiliated directors. Except as otherwise restricted, the Board of Directors may revise the policies without the consent of stockholders if the Board of Directors determines that the change is in the best interests of stockholders. Developments in the market which affect the policies and strategies mentioned herein or which change Hanover's assessment of the market may cause the Board of Directors to revise Hanover's policies and financing strategies.

FEDERAL INCOME TAX CONSIDERATIONS

General

We have elected to be treated as a Real Estate Investment Trust, or REIT, for Federal income tax purposes, pursuant to the Code. In brief, if certain detailed conditions imposed by the REIT provisions of the Code are met, entities that invest primarily in real estate investments and mortgage loans, and that otherwise would be taxed as corporations are, with certain limited exceptions, not taxed at the corporate level on their taxable income that is currently distributed to their shareholders. This treatment eliminates most of the "double taxation" (at the corporate level and then again at the shareholder level when the income is distributed) that typically results from the use of corporate investment vehicles. In the event that Hanover does not qualify as a REIT in any year, it would be subject to Federal income tax as a domestic corporation

and the amount of Hanover's after-tax cash available for distribution to its shareholders would be reduced. Hanover believes it has satisfied the requirements for qualification as a REIT since commencement of its operations in September 1997. Hanover intends at all times to continue to comply with the requirements for qualification as a REIT under the Code, as described below.

REITs currently enjoy a competitive advantage over regular C corporations in that their distributed earnings are taxed only once, whereas a regular C corporation's distributed earnings are generally taxed twice. The President has submitted a legislative proposal to Congress involving a dividend exclusion for distributions of earnings that have been subjected to corporate level tax. If enacted, the proposal might eliminate, or at least reduce, REITs' current competitive advantage.

Requirements for Qualification as a REIT

To qualify for income tax treatment as a REIT under the Code, Hanover must meet certain tests which are described briefly below.

- - Ownership of Common Stock

For all taxable years after its first taxable year, Hanover's shares of capital stock must be held by a minimum of 100 persons for at least 335 days of a 12-month year (or a proportionate part of a short tax year). In addition, at any time during the second half of each taxable year, no more than 50% in value of Hanover's capital stock may be owned directly or indirectly by five or fewer individuals, taking into account complex attribution of ownership rules. Hanover is required to maintain records regarding the actual and constructive ownership of its shares, and other information, and to demand statements from persons owning above a specified level of the REIT's shares (if Hanover has 200 or fewer shareholders of record, from persons holding 0.5% or more of Hanover's outstanding shares of capital stock) regarding their ownership of shares. Hanover must keep a list of those shareholders who fail to reply to such a demand. Hanover is required to use (and does use) the calendar year as its taxable year for income tax reporting purposes.

- - Nature of Assets

On the last day of each calendar quarter, Hanover must satisfy three tests relating to the nature of its assets. First, at least 75% of the value of Hanover's assets must consist of mortgage loans, certain interests in mortgage loans, real estate, certain interests in real estate, shares (or transferable certificates of beneficial interest) in another REIT, government securities, cash and cash items (the foregoing, "Qualified REIT Assets"). Hanover expects that substantially all of its assets will continue to be Qualified REIT Assets. Second, not more than 25% of Hanover's assets may consist of securities that are not Qualified REIT Assets. Third, except as noted below, investments in securities that are not Qualified REIT Assets are further limited as follows: (i) not more than 20% of the value of Hanover's total assets can be represented by securities of one of more Taxable REIT Subsidiaries (as defined below), (ii) the value of any one issuer's securities may not exceed 5% by value of Hanover's total assets, (iii) Hanover may not own securities possessing more than 10% of the total voting power of any one issuer's outstanding voting securities, and (iv) Hanover may not own securities having a value of more than 10% of the total value of any one issuer's outstanding securities. Clauses (ii), (iii) and (iv) of the third asset test do not apply to securities of a Taxable REIT Subsidiary. A "Taxable REIT Subsidiary" is any corporation in which a REIT owns stock, directly or indirectly, if the REIT and such corporation jointly elect to treat such corporation as a Taxable REIT Subsidiary. The amount of debt and rental payments from a Taxable REIT Subsidiary to a REIT are limited to ensure that a Taxable REIT Subsidiary is subject to an appropriate level of corporate tax.

Pursuant to its compliance guidelines, Hanover intends to monitor closely the purchase and holding of its assets in order to comply with the above asset tests.

- - Sources of Income

Hanover must meet the following two separate income-based tests each year:

1. 75% INCOME TEST. At least 75% of Hanover's gross income for the taxable year must be derived from certain real estate sources including interest on obligations secured by mortgages on real property or interests in real property. Certain temporary investment income will also qualify under the 75% income test. The investments that Hanover has made and expects to continue to make will give rise primarily to mortgage interest qualifying under the 75% income test.

2. 95% INCOME TEST. In addition to deriving 75% of its gross income from the sources listed above, at least an additional 20% of Hanover's gross income for the taxable year must be derived from those sources, or from dividends, interest or gains from the sale or disposition of stock or other securities that are not dealer property. Hanover intends to limit substantially all of the assets that it acquires to assets that can be expected to produce income that qualifies under the 75% Income Test. Hanover's policy to maintain REIT status may limit the types of assets, including hedging contracts and other securities, that Hanover otherwise might acquire.

- - Distributions

Hanover must distribute to its shareholders on a pro rata basis each year an amount equal to at least (i) 90% of its taxable income before deduction of dividends paid and excluding net capital gains, plus (ii) 90% of the excess of the net income from foreclosure property over the tax imposed on such income by the Code, less (iii) certain "excess noncash income." Hanover intends to make distributions to its shareholders in sufficient amounts to meet this 90% distribution requirement.

If it fails to distribute to its shareholders with respect to each calendar year at least the sum of (i) 85% of its REIT ordinary income of the year, (ii) 95% of its REIT capital gain net income for the year, and (iii) any undistributed taxable income from prior years, Hanover will be subject to a 4% excise tax on the excess of the required distribution over the amounts actually distributed.

State Income Taxation

The REIT files corporate income tax returns in various states. These states treat the income of the REIT in a similar manner as for Federal income tax purposes. Certain state income tax laws with respect to REITs are not necessarily the same as Federal law. Thus, differences in state income taxation as compared to Federal income taxation may exist in the future. The REIT is subject to a New Jersey gross receipts tax (Alternative Minimum Assessment).

Taxation of Hanover's Shareholders

For any taxable year in which Hanover is treated as a REIT for Federal income tax purposes, amounts distributed by Hanover to its shareholders out of current or accumulated earnings and profits will be includable by the shareholders as ordinary income for Federal income tax purposes unless properly designated by Hanover as capital gain dividends. Dividends declared during the last quarter of a calendar year and actually paid during January of the immediately following calendar year are generally treated as if received by the shareholders on December 31 of the calendar year during which they were declared. Hanover's distributions will not be eligible for the dividends received deduction for corporations. Shareholders may not deduct any of Hanover's net operating losses or capital losses. If Hanover designates one or more dividends, or parts thereof, as a capital gain dividend in a written notice to the shareholders, the shareholders shall treat as long-term capital gain the lesser of (i) the aggregate amount so designated for the taxable year or (ii) Hanover's net capital gain for the taxable year. Each shareholder will include in his long-term capital gains for the taxable year such amount of Hanover's undistributed as well as distributed net capital gain, if any, for the taxable year as is designated by Hanover in a written notice. Hanover will be subject to a corporate level tax on such undistributed gain and the shareholder will be deemed to have paid as an income tax for the taxable year his distributive share of the tax paid by Hanover on the undistributed gain.

Any loss on the sale or exchange of shares of Hanover's common stock held by a shareholder for six months or less will be treated as a long-term capital loss to the extent of any capital gain dividends received (or undistributed capital gain included) with respect to the common stock held by such shareholder.

If Hanover makes distributions to its shareholders in excess of its current and accumulated earnings and profits, those distributions will be considered first a tax-free return of capital, reducing the tax basis of a shareholder's shares until the tax basis is zero. Such distributions in excess of the tax basis will be taxable as gain realized from the sale of Hanover's shares. Hanover will withhold 30% of dividend distributions to shareholders that Hanover knows to be foreign persons unless the shareholder provides Hanover with a properly completed IRS form claiming a reduced withholding rate under an applicable income tax treaty.

Under the Code, if a portion of Hanover's assets were treated as a taxable mortgage pool or if Hanover were to hold REMIC residual interests, a portion of Hanover's dividends would be treated as unrelated business taxable income ("UBTI") for pension plans and other tax exempt entities. Hanover believes that it has not engaged in activities that would cause any portion of Hanover's income to be taxable as UBTI for pension plans and similar tax-exempt shareholders. Hanover believes that its shares of stock will be

treated as publicly offered securities under the plan asset rules of the Employment Retirement Income Security Act ("ERISA") for Qualified Plans.

The provisions of the Code are highly technical and complex and are subject to amendment and interpretation from time to time. This summary is not intended to be a detailed discussion of all applicable provisions of the Code, the rules and regulations promulgated thereunder, or the administrative and judicial interpretations thereof. Hanover has not obtained a ruling from the Internal Revenue Service with respect to tax considerations relevant to its organization or operations.

ITEM 2. PROPERTIES

Our operations are conducted in several leased office facilities throughout the United States. A summary of the office leases is shown below:

LOCATION	SEGMENT	OFFICE SPACE (SQ. FT.)	CURRENT ANNUAL RENTAL	EXPIRATION DATE	OFFICE USE
Edison, New Jersey	HanoverTrade, Inc. and Hanover Capital Mortgage Holdings, Inc.	5,200	\$137,800	April 2005	Executive, Administration, Accounting, Marketing, Investment Operations, Mortgage Loan Servicing
Edison, New Jersey	Hanover Capital Partners Ltd.	9,724	160,932	April 2005	Administration, Due Diligence Operations, Assignment Operations
New York, New York	Hanover Capital Mortgage Holdings, Inc.	1,000	39,444	September 2007	Executive, Administration, Investment Operations
Ft. Lauderdale, Florida	HanoverTrade, Inc.	875	24,579	April 2003	Marketing
Jacksonville, Florida	HanoverTrade, Inc.	470	18,000	November 2003	Technology Support
Chicago, Illinois	HanoverTrade, Inc.	1,151	24,123	January 2004	Marketing
Alpharetta, Georgia	HanoverTrade, Inc.	160	14,700	January 2004	Marketing
St. Paul, Minnesota	Hanover Capital Partners Ltd.	168	11,340	Month to Month	Marketing
Total		18,748	\$430,918		

We believe that these facilities are adequate for our foreseeable office space needs and that lease renewals and/or alternate space at comparable rental rates are available, if necessary.

ITEM 3. LEGAL PROCEEDINGS

From time to time, we are involved in litigation incidental to the conduct of our business. We are not currently a party to any lawsuit or proceeding which, in the opinion of management, is likely to have a material adverse effect on our business, financial condition or results of operations.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

- (a) Our common stock is traded on the American Stock Exchange under the trading symbol HCM. As of March 1, 2003, 4,534,402 shares of our common stock were issued and outstanding, held by 50 holders of record and approximately 2,300 beneficial owners.

The following table sets forth, for the periods indicated, the high, low and closing sales price of our common stock as reported on the American Stock Exchange in 2001 and 2002.

	COMMON STOCK		
	High ----	Low -----	Close -----
Quarter Ended March 31, 2001	7.11	5.13	6.50
Quarter Ended June 30, 2001	7.85	6.30	7.00
Quarter Ended September 30, 2001	7.50	6.51	6.55
Quarter Ended December 31, 2001	8.15	6.55	8.00
Quarter Ended March 31, 2002	8.65	7.25	8.65
Quarter Ended June 30, 2002	10.10	8.15	8.18
Quarter Ended September 30, 2002	8.60	7.15	7.30
Quarter Ended December 31, 2002	7.75	6.09	7.04

The following table sets forth, for the periods indicated, dividends declared on our common stock for each quarter for the two most recent fiscal years:

	PER-SHARE
	DIVIDENDS DECLARED -----
Quarter Ended March 31, 2001	\$0.20
Quarter Ended June 30, 2001	\$0.20
Quarter Ended September 30, 2001	\$0.20
Quarter Ended December 31, 2001	\$0.20
Quarter Ended March 31, 2002	\$0.25
Quarter Ended June 30, 2002	\$0.25
Quarter Ended September 30, 2002	\$0.25
Quarter Ended December 31, 2002	\$0.25

We intend to pay quarterly dividends and other distributions to our shareholders of all or substantially all of our taxable income in each year to qualify for the tax benefits accorded to a REIT under the Code. To the extent that we record capital gain income in future years, this income does not need to be distributed as dividends to shareholders to the extent of unutilized capital losses recorded (more than \$8,678,000 as of December 31, 2002). These capital losses expire at the end of the year 2003. All distributions will be made at the discretion of our Board of Directors and will depend on our earnings, financial condition, maintenance of REIT status and such other factors as the Board of Directors deems relevant.

- (b) Item 201(d)

See Part III, Item 12 hereof.

(c) On July 1, 2002, we cancelled outstanding options that had been issued under our 1997 Executive and Non-Employee Stock Option Plan in connection with our initial public offering. The cancelled options had an exercise price of \$15.75 per share, were exercisable for an aggregate of 80,160 shares of our common stock, and were subject to vest based on our achievement of certain performance targets based on increases in the market value of our common stock over our initial offering price. None of the targets were met within the available vesting period, so none of the original options ever vested. To replace these cancelled options we granted new options, exercisable for an aggregate of 80,160 shares of our common stock at an exercise price of \$15.75 per share, to the following executive officers: John A. Burchett, Joyce S. Mizerak, George J. Ostendorf and Irma N. Tavares. These option grants were exempt from registration pursuant to Section 4(2) of the Securities Act of 1933. The replacement options are subject to performance-based vesting similar to the cancelled options, but the vesting period has been extended until 2007 and the performance targets were adjusted to relate to increases in the market price of our common stock as compared to the market price on July 1, 2002.

ITEM 6. SELECTED FINANCIAL DATA

The following selected financial data are derived from our audited consolidated financial statements for the years ended December 31, 2002, 2001, 2000, 1999 and 1998. The selected financial data should be read in conjunction with the more detailed information contained in our Consolidated Financial Statements and Notes thereto and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included elsewhere in this Form 10-K (dollars in thousands, except per share data):

STATEMENT OF OPERATIONS HIGHLIGHTS

	Years Ended December 31,				
	2002	2001	2000	1999	1998
Net interest income	\$ 6,092	\$ 6,269	\$ 6,663	\$ 4,408	\$ 6,623
Loan loss provision	(393)	(709)	(875)	(446)	(356)
Gain (loss) on sale and mark to market of mortgage assets	3,462	4,533	1,250	(4,146)	(5,704)
Loan brokering/trading, due diligence fees and other	6,594	(28)	--	(1,685)	--
Provision for loss on unconsolidated subsidiary	--	--	--	(4,793)	--
Total revenue (loss)	15,755	10,065	7,038	(6,662)	563
Expenses	11,473	3,696	3,136	4,191	4,064
Operating income (loss)	4,282	6,369	3,902	(10,853)	(3,501)
Equity in income (loss) of unconsolidated subsidiaries					
Hanover Capital Partners Ltd.	112	43	455	(443)	(1,039)
HanoverTrade, Inc.	655	(3,263)	(1,495)	(31)	--
HDMF-I LLC	157	(35)	--	--	--
Hanover Capital Partners 2, Inc.	(19)	--	--	(1,300)	(394)
	905	(3,255)	(1,040)	(1,774)	(1,433)
Income (loss) before income tax provision (benefit) and cumulative effect of adoption of SFAS 133	5,187	3,114	2,862	(12,627)	(4,934)
Income tax provision	49	--	--	--	--
Income (loss) before cumulative effect of adoption of SFAS 133	5,138	3,114	2,862	(12,627)	(4,934)
Cumulative effect of adoption of SFAS 133	--	46	--	--	--
Net income (loss)	\$ 5,138	\$ 3,160	\$ 2,862	\$ (12,627)	\$ (4,934)
Basic earnings (loss) per share	\$ 1.16	\$ 0.74	\$ 0.56	\$ (2.12)	\$ (0.77)
Diluted earnings (loss) per share	\$ 1.15	\$ 0.73	\$ 0.56	\$ (2.12)	\$ (0.77)
Dividends declared per share	\$ 1.00	\$ 0.80	\$ 0.66	\$ 0.50	\$ 0.70

BALANCE SHEET HIGHLIGHTS

	December 31,				
	2002	2001	2000	1999	1998
Mortgage loans	\$ 103,164	\$ 154,273	\$ 212,247	\$ 270,084	\$ 407,994
Mortgage securities	23,903	51,183	35,723	62,686	78,478
Cash and cash equivalents	10,605	8,946	9,958	18,022	11,837
Other assets	18,199	15,105	14,681	14,842	17,861
Total assets	\$ 155,871	\$ 229,507	\$ 272,609	\$ 365,634	\$ 516,170
Reverse repurchase agreements	\$ 6,283	\$ 33,338	\$ 14,760	\$ 55,722	\$ 370,090
CMO borrowing	102,589	151,096	210,374	254,963	77,305
Other liabilities	3,935	3,532	3,451	4,443	2,995
Total liabilities	112,807	187,966	228,585	315,128	450,390
Stockholders' equity	43,064	41,541	44,024	50,506	65,780
Total liabilities and stockholders' equity	\$ 155,871	\$ 229,507	\$ 272,609	\$ 365,634	\$ 516,170
Number of common shares outstanding	4,474,222	4,275,676	4,322,944	5,826,899	6,321,899
Book value per common share	\$ 9.62	\$ 9.72	\$ 10.18	\$ 8.67	\$ 10.41

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

IMPORTANT FACTORS RELATED TO FORWARD-LOOKING STATEMENTS AND ASSOCIATED RISKS

The following section, "Management's Discussion and Analysis of Financial Condition and Results of Operations," should be read in conjunction with the financial statements, related notes, and other detailed information included elsewhere in this Annual Report on Form 10-K. This report contains certain "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements represent our current expectations, intentions or beliefs regarding future events or trends, including, without limitation, statements containing the words "believes," "anticipates," "expects," "intends," "assumes," "will," or other similar expressions; and also including, without limitation, the following: our business strategy; market trends and risks; statements regarding our continuing ability to target, price and acquire MBS or mortgage loans; our ability to manage and hedge the risks associated with our investments; assumptions regarding interest rates and their effect on our hedging strategies; assumptions regarding prepayment and default rates on the mortgage loans securing our MBS and their effect on our hedging strategies; our decision to invest in higher-risk subordinated tranches; the liquidity of our portfolios and our ability to invest currently liquid assets; the expected future performance of Hanover Capital Partners and HanoverTrade and their need for additional capital; continuing availability of the master reverse repurchase agreement financing or other financing; the sufficiency of our working capital, cash flows and financing to support our future operating and capital requirements; results of operations and overall financial performance; the expected dividend distribution rate; our ability to enter into additional asset management contracts with third parties; the adequacy of our leased office space; our ability to locate additional funds for HDMF-I; our expectations regarding the effects of accounting rules and changes thereto; changes in government regulations affecting our business; and the expected tax treatment of our operations. Such forward-looking statements relate to future events and our future financial performance and involve known and unknown risks, uncertainties and other important factors, many of which are beyond our control, which could cause actual results, performance or achievements to differ materially from those expressed or implied by such forward-looking statements.

In light of the risks and uncertainties inherent in all such projected operational matters, the inclusion of forward-looking statements in this report should not be regarded as a representation by us or any other person that our objectives or plans will be achieved or that any of our operating expectations will be realized. Our revenues and results of operations are difficult to forecast and could differ materially from those projected in the forward-looking statements contained in this report as a result of certain risks and uncertainties including, but not limited to: changes in interest rates and the yield curve; management of growth; changes in prepayment rates or default rates on our mortgage assets; our ability to borrow at favorable rates and terms; changes in business conditions and the general economy; our dependence on effective information-systems technology; potential declines in our ability to locate and acquire desirable mortgage assets; changes in the real estate market both locally and nationally; the effectiveness of our hedging and other efforts to mitigate the risks of our investments; the effect of default, bankruptcy and severe weather or natural disasters on the ability of borrowers to repay mortgages included in our asset pools; enforceability and collectibility of non-standard single-family mortgage loans; our ability to retain key employees; our ability to maintain our qualification for exemption from registration as an investment company; our ability to obtain and maintain all licenses necessary to our business; competition from other financial institutions, including other mortgage real estate investment trusts, or REITs; and the possible changes in tax and other laws applicable to REITs or our inability to maintain compliance with such rules and to continue to qualify as a REIT. Investors should carefully consider the various factors identified in "Management's Discussion and Analysis of Financial Condition and Results of Operation - Risk Factors," and elsewhere in this Annual Report on Form 10-K that could cause actual results to differ materially from the results predicted in the forward-looking statements. These factors should not be considered exhaustive; we undertake no obligation to release publicly the results of any future revisions we may make

to forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

OVERVIEW

We are a specialty finance company organized in June 1997 as a REIT. At December 31, 2002, we had two principal consolidated subsidiaries, Hanover Capital Partners Ltd., which we refer to as HCP, and HanoverTrade, Inc., which we refer to as HT. When we use the terms "we", "us", "our" or "the Company," we are referring to our company and its consolidated and unconsolidated subsidiaries taken as a whole. To provide more meaningful disclosure, we occasionally wish to report information regarding only our REIT entity without reference to any of its subsidiaries. In those instances, we refer to the REIT entity as "Hanover."

Hanover's principal business strategy is to invest in mortgage-backed securities, which we refer to as MBS, and, to a lesser extent, mortgage loans and to earn net interest income on these investments. HCP's principal business strategy is to generate consulting and other fee income by performing loan sale advisory services, loan file due diligence reviews, staffing solutions and mortgage assignment and collateral rectification services. HT's principal business strategy is to generate fee income by operating an Internet exchange for trading mortgage loans, mortgage servicing rights and related assets, and providing state-of-the art technologies supported by experienced valuation, operations and trading professionals. In addition to trading assets, HT provides a full range of asset valuation, analysis and marketing services for: performing, sub-performing and non-performing assets; whole loans and participations; Community Reinvestment Act loans; and mortgage servicing rights. In addition, Hanover has an equity interest in HDMF-I LLC, a limited liability company formed to purchase, service, manage or otherwise liquidate pools of primarily sub- and non-performing one-to-four family residential mortgage loans.

Hanover operates as a tax-advantaged REIT and is generally not subject to Federal and state income tax to the extent that it distributes its taxable earnings to its stockholders and maintains its qualification as a REIT. Hanover's taxable affiliates, however, are subject to Federal and state income tax. Hanover has engaged HCP to render due diligence, asset management and administrative services pursuant to a Management Agreement.

CRITICAL ACCOUNTING POLICIES

The significant accounting policies used in preparation of our financial statements are more fully described in Note 2 to our consolidated financial statements. Certain critical accounting policies are complex and involve significant judgment by our management, including the use of estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. As a result, changes in these estimates and assumptions could significantly affect our financial position or our results of operations. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results may differ from these estimates under different assumptions or conditions. We believe that of our significant accounting policies, the following involve a high degree of judgment and complexity in the preparation of our consolidated financial statements:

MORTGAGE SECURITIES - Our mortgage securities are designated as either available for sale, trading or held to maturity. Mortgage securities designated as available for sale are reported at fair value, with unrealized gains and losses excluded from earnings and reported as a separate component of stockholders' equity. Mortgage securities designated as trading are reported at fair value. Gains and losses resulting from changes in fair value are recorded as income or expense and included in earnings. Mortgage securities classified as held to maturity are carried at amortized cost unless a decline in value is deemed other than temporary, in which case the carrying value is reduced. Because our assets are generally not traded on a

national securities exchange or national automated quotation system and prices are therefore not readily ascertainable, complex cash flow modeling is performed in determining their fair value. Several of the assumptions used by management are confirmed by independent third parties on at least a quarterly basis. In using cash-flow analysis to determine fair value, future cash flows are based on estimates of prepayments, the impact of interest rate movements on yields, delinquency of the underlying loans and estimated probable losses based on historical experience and estimates of expected future performance. As a result, a high degree of judgment is required in estimating the assumptions used in the cash flow analysis. Should the estimates used by management be inaccurate, our net interest income could be materially affected.

LOAN LOSS ALLOWANCE - We maintain a loan loss allowance for our subordinate MBS and collateral for collateralized mortgage obligations, or CMOs. We monitor the delinquencies and defaults on the underlying mortgages and, if an impairment of the related mortgage security is deemed to be other than temporary, reduce the carrying value of the related mortgage security to fair value. Our loan loss provision is based on our assessment of numerous factors affecting our portfolio of mortgage securities including, but not limited to, current and projected economic conditions, delinquency status, credit losses to date on underlying mortgages and remaining credit protection. Loan loss provision estimates are reviewed periodically and adjustments are reported in earnings when they become known. Should our estimates be inaccurate, our loan loss provision could be materially affected which could result in unexpected gains or losses from future sales of such assets.

EQUITY INVESTMENTS - Hanover records its investment in HDMF-I LLC, which we refer to as HDMF-I, on the equity method. Accordingly, Hanover records its proportionate share of the earnings or losses of HDMF-I. This presentation, while required under accounting principles generally accepted in the United States of America, does not present the assets and liabilities of HDMF-I on our balance sheet. In addition, the residual equity that Hanover does not own remains "off balance sheet."

REVENUE RECOGNITION - HCP recognizes revenue from due diligence contracts in progress as they are earned. To calculate what percentage of the total revenue of a contract has been earned, management must make estimates. Estimates, by their nature, are based on judgment and available information. Actual results could differ from estimates. As the majority of HCP's revenue relates to services performed, such estimates may include the amount of time spent by individuals in consideration of the aggregate amount of time required to complete the contract, the evaluation of both quantitative and qualitative criteria as agreed to and maintained in the contract and possibly regulations set forth by the government should the contract be with an agency of the Federal government.

HT recognizes revenues from loan sale advisory and trading when the transactions close and fees are earned and billed. At the time of closing a transaction, the number of loans, loan principal balance and purchase price in the transaction are agreed upon, documentation is signed and the sale is funded. HT's billing of fees relating to a transaction occurs concurrently with the closing and funding.

We utilize guidance set forth in the Securities and Exchange Commission's Staff Accounting Bulletin No. 101, Revenue Recognition in Financial Statements ("SAB 101"). SAB 101 draws on existing accounting rules with respect to the basic criteria that must be met before revenue can be recorded. SAB 101 further explains how those rules apply. We have reviewed the guidance in SAB 101 and believe we are in compliance with SAB 101. However, if management's estimates are incorrect, or if we are not applying SAB 101 as intended, the results of operations could be materially affected.

INCOME TAXES - Hanover has elected to be taxed as a REIT and intends to comply with the REIT provisions of the Internal Revenue Code of 1986, as amended, which we refer to as the Code. Accordingly, Hanover will not be subject to Federal or state income tax on net income that is currently distributed to stockholders to the extent that its annual distributions to stockholders are equal to at least 90% of its taxable income and as long as certain asset, income and stock ownership tests are met. In the event that Hanover does not qualify as a REIT in any year, it would be subject to Federal income tax as a

domestic corporation and the amount of Hanover's after-tax cash available for distribution to its stockholders would be reduced. Hanover believes it has satisfied the requirements for qualification as a REIT since commencement of its operations in September 1997. Hanover intends at all times to continue to comply with the requirements for qualification as a REIT under the Code.

RESULTS OF OPERATIONS

In our description of financial results presented below, we use the term "Hanover" to refer to Hanover Capital Mortgage Holdings, Inc. as a separate entity. Hanover has two primary operating subsidiaries: Hanover Capital Partners Ltd., which we refer to as "HCP", and HanoverTrade, Inc., which we refer to as "HT". When we use the terms "we", "us", or "our", we are referring to Hanover together with its consolidated and unconsolidated subsidiaries. The term "CMO" refers to collateralized mortgage obligations, in which financing is obtained in exchange for a pledge of mortgages, or pools of mortgages, as collateral. We use the term "MBS" to refer to mortgage-backed securities.

On July 1, 2002, Hanover acquired 100% of the outstanding capital stock of each of HT, HCP, and Hanover Capital Partners 2, Inc., which we refer to as HCP-2. Hanover had previously owned 100% of the non-voting preferred stock, but none of the voting common stock, of each of these entities. Prior to July 1, 2002, the financial results for these three entities appeared in our financial statements as a single line-item under "equity in income or loss of unconsolidated subsidiaries." Due to the stock purchase, for periods ending after June 30, 2002, Hanover's financial statements will be consolidated with the financial statements of those entities. This means that the financial results for these three entities, whether positive or negative, will appear throughout our financial statements as applicable, rather than in a single line-item. To assist you in evaluating the effect of the stock purchase on our financial results, our discussion below sometimes includes information regarding both "previously reported" and "pro forma" financial results. "Previously reported" financial results provide the actual results for the periods presented, which means that they do not give effect to the stock purchase for any periods prior to July 1, 2002. "Pro forma" financial results provide financial information for the periods shown as if the stock purchase of HT, HCP and HCP-2 had been completed as of January 1, 2001 for statement of income purposes. "Pro forma" financial information is presented for illustrative purposes only. Pro forma information is not necessarily indicative of the financial position or results of operations that would have been reported had the acquisition occurred on January 1, 2001, and these presentations do not necessarily indicate the future financial position or results of operations.

The following table presents the consolidated results of operations as previously reported for 2002, 2001 and 2000 and pro forma results for 2002 and 2001 (dollars in thousands):

	As Previously Reported - Years Ended December 31,			Pro Forma - Years Ended December 31,	
	2002	2001	2000	2002	2001
				(unaudited)	
Net interest income	\$ 6,092	\$ 6,269	\$ 6,663	\$ 6,375	\$ 5,871
Loan loss provision	(393)	(709)	(875)	(393)	(709)
Gain on sale of mortgage assets	2,095	3,782	819	2,095	3,782
Gain on mark to market of mortgage assets, net of associated hedge	1,367	751	431	1,237	695
Loan brokering, trading and advisory services	2,686	--	--	6,831	3,521
Due diligence fees	2,891	--	--	4,971	5,083
Assignment fees	1,387	--	--	2,220	757
Other income (loss)	(370)	(28)	--	(399)	58
Total revenue	15,755	10,065	7,038	22,937	19,058
Expenses	11,473	3,696	3,136	17,805	15,987
Operating income	4,282	6,369	3,902	5,132	3,071
Equity in income (loss) of unconsolidated subsidiaries:					
Hanover Capital Partners Ltd.	112	43	455	--	--
HanoverTrade, Inc.	655	(3,263)	(1,495)	--	--
HDMF-I LLC	157	(35)	--	157	(35)
Hanover Capital Partners 2, Inc.	(19)	--	--	--	--
Income before income tax provision and cumulative effect of adoption of SFAS 133	5,187	3,114	2,862	5,289	3,036
Income tax provision	49	--	--	127	64
Income before cumulative effect of adoption of SFAS 133	5,138	3,114	2,862	5,162	2,972
Cumulative effect of adoption of SFAS 133	--	46	--	--	46
Net income	\$ 5,138	\$ 3,160	\$ 2,862	\$ 5,162	\$ 3,018
Basic earnings per share	\$ 1.16	\$ 0.74	\$ 0.56	\$ 1.17	\$ 0.71
Dividends declared per share	\$ 1.00	\$ 0.80	\$ 0.66	\$ 1.00	\$ 0.80

Net Income, Basic Earnings Per Share and Total Revenue

We recorded net income of \$5,138,000 or \$1.16 per share based on 4,417,221 weighted average shares of common stock outstanding for 2002 compared to net income of \$3,160,000 or \$0.74 per share based on 4,256,874 weighted average common shares outstanding for 2001, and net income of \$2,862,000 or \$0.56 per share based on 5,102,563 weighted shares of common stock outstanding for 2000. Total revenue for 2002 was \$15,755,000, compared to \$10,065,000 previously reported for 2001 and \$7,038,000 for 2000. On a pro forma basis, total revenue for the 2002 period was \$22,937,000, while total revenue for the 2001 period was \$19,058,000.

Net Interest Income and Loan Loss Reserve

The following table reflects the average balances for each major category of our interest earning assets as well as our interest bearing liabilities with the corresponding effective yields and rates of interest as follows (dollars in thousands):

INTEREST EARNING ASSETS AND RELATED LIABILITIES

	Years Ended December 31,					
	2002		2001		2000	
	Average Balance	Effective Rate (1)	Average Balance	Effective Rate (1)	Average Balance	Effective Rate (1)
Interest earning assets:						
Mortgage loans	\$ 1,206	16.75%	\$ 231	8.10%	\$ 300	87.79%
CMO collateral	136,512	7.09%	193,840	7.41%	247,850	7.46%
Agency-issued MBS	7,186	6.70%	15,401	7.98%	41,072	7.28%
Private placement notes	14,257	15.13%	14,676	17.11%	20,266	16.84%
	-----	-----	-----	-----	-----	-----
	159,161	7.87%	224,148	8.08%	309,488	8.13%
	-----	-----	-----	-----	-----	-----
Interest bearing liabilities:						
CMO borrowings	124,971	5.57%	181,669	6.72%	233,843	7.49%
Reverse repurchase borrowings on:						
CMO collateral	1,786	2.97%	2,536	7.16%	3,515	7.45%
Agency-issued MBS	6,410	3.32%	9,732	6.40%	29,020	5.71%
Private placement notes	6,127	3.42%	6,085	6.86%	7,544	7.81%
	-----	-----	-----	-----	-----	-----
	139,294	5.34%	200,022	6.71%	273,922	7.31%
	-----	-----	-----	-----	-----	-----
Net interest earning assets	\$ 19,867		\$ 24,126		\$ 35,566	
	=====		=====		=====	
Net interest spread		2.53%		1.37%		0.82%
		=====		=====		=====
Yield on net interest earning assets (2)		25.58%		19.45%		14.43%
		=====		=====		=====

(1) Loan loss provisions are included in the above calculations.

(2) Yield on net interest earning assets is computed by dividing the applicable net interest income after loan loss provision by the average daily balance of net interest earning assets.

The following table provides details of net interest income and loan loss provision for interest earning assets as follows (dollars in thousands):

NET INTEREST INCOME

	Years Ended December 31,					
	2002		2001		2000	
	Net Interest Income	Loan Loss Provision	Net Interest Income	Loan Loss Provision	Net Interest Income	Loan Loss Provision
Mortgage loans	\$ 202	\$ --	\$ 19	\$ --	\$ 264	\$ --
CMO collateral	2,826	(161)	2,219	(246)	963	(249)
Agency-issued MBS	268	--	606	--	1,330	--
Private placement MBS	2,179	(232)	2,556	(463)	3,450	(626)
Other	868	--	869	--	656	--
Eliminations	(251)	--	--	--	--	--
Total net interest income	\$6,092	\$(393)	\$6,269	\$(709)	\$6,663	\$(875)

Years Ended December 31, 2002 and 2001

Net interest income decreased to \$6,092,000, or \$1.38 per share, for 2002 from \$6,269,000, or \$1.47 per share, as previously reported in 2001. The decrease in net interest income of \$177,000 was primarily due to:

- the repayment of our mortgage loans held as collateral for CMOs offset by decreased borrowing costs on our corresponding CMO liabilities and reverse repurchase agreements;
- the termination of Agency-issued MBS activity; and
- the decrease in the average coupon rate of our purchased subordinate MBS portfolio, decrease in the interest earned from interest-only notes retained from our 1998-B securitization, and interest income earned from trading activity conducted by one of our subsidiaries in 2002; no such trading activity occurred in 2001.

The effective yield on our average CMO collateral decreased slightly to 7.09% in 2002 from 7.41% in 2001, while the effective rate of interest on our average CMO borrowings decreased to 5.57% in 2002 from 6.72% in 2001. Our effective borrowings rate decreased faster than the decrease in the yield on average assets. In addition, we recognized increased interest income from our interest-only notes retained from our 1999-B securitization. These interest-only notes earned interest at a rate of 4.00% in 2002 compared to 1.86% in 2001.

Net interest income from Agency-issued MBS decreased in 2002 because we terminated our investment in such MBS in July of 2002.

Private placement MBS net interest income was negatively impacted by a decrease in the effective interest rate earned on our purchased subordinate MBS portfolio to 12.53% in 2002 from 16.77% in 2001. The decrease in net interest income recognized from interest-only notes retained from our 1998-B securitization resulted from a decrease in the average notional amount on which interest income is earned to \$119.7 million in 2002 from \$196.1 million in 2001.

During December 2002 and January 2003, we exercised call provisions in our 1998-A and 1998-B securitizations and sold the underlying mortgage loans in February and March 2003. As a result of the two sales, we have approximately \$6,000,000 available for reinvestment. We cannot assure you that we will be able to reinvest the proceeds in a profitable manner.

On a pro forma basis, net interest income increased to \$6,375,000 for 2002 from \$5,871,000 for 2001. The \$504,000 increase is due to a full year of net interest income on a pro forma basis in 2002 attributable to trading activity, partially offset by reduced Agency-issued MBS activity.

Our provision for loan losses decreased to \$393,000 in 2002 from \$709,000 in 2001. The \$316,000 decrease was primarily the result of sales of first-loss subordinate MBS and a reduction in the average balance of collateral for CMOs. First-loss subordinate MBS are generally structured to absorb the credit losses resulting from a specified pool of mortgages. As a result, we provide for the estimated losses associated with first-loss subordinate MBS, which increases our overall loan loss allowance. If our loss estimates differ materially from actual results, we could incur additional losses resulting in decreased net income in future periods. No adjustments were required on a pro forma basis because the provision for loan losses relates only to Hanover during these periods.

Years Ended December 31, 2001 and 2000

Net interest income decreased to \$6,269,000 in 2001 compared to \$6,663,000 in 2000. The decrease in net interest income of \$394,000 was primarily a result of:

- an increase in amortization expense for whole loans as a result of increases in assumed prepayment speeds; and
- a reduction in the principal balance of Hanover sponsored securitizations of whole loans partially offset by a corresponding reduction in the principal balance of CMO borrowings against such whole loans.

Our provision for loan losses decreased to \$709,000 in 2001 from \$875,000 in 2000, primarily as a result of sales of first-loss subordinate MBS, and a reduction in the average balance of collateral from CMOs. Provision for losses on Hanover sponsored securitizations decreased to \$246,000 in 2001 from \$319,000 in 2000. Provision for loan losses on subordinate MBS purchased from third parties decreased to \$463,000 in 2001 from \$555,000 in 2000. The average balance of subordinate MBS purchased from third parties in 2001 was \$12,664,000 compared to \$11,973,000 in 2000.

The following tables provide details of net interest income and loan loss provision by interest earning asset:

CMO Collateral

Net interest income generated from the CMO collateral (including mortgage loans and MBS pledged to CMOs) is as follows (dollars in thousands):

	Years Ended December 31,		
	2002	2001	2000
Average asset balance	\$ 136,512	\$ 193,840	\$ 247,850
Average CMO borrowing balance	124,971	181,669	233,843
Average reverse repurchase agreement borrowing balance	1,786	2,536	3,515
Net interest earning assets	9,755	9,635	10,492
Average leverage ratio	92.85%	95.03%	95.77%
Effective interest income rate	7.21%	7.54%	7.56%
Effective interest expense rate	5.57%	6.72%	7.49%
Effective interest expense rate - Repurchase agreements	2.97%	7.16%	7.45%
Net interest spread	1.67%	0.81%	0.07%
Interest income	\$ 9,841	\$ 14,612	\$ 18,745
Interest expense	6,962	12,211	17,521
Interest expense - Repurchase agreements	53	182	261
Net interest income before loan loss provision	2,826	2,219	963
Loan loss provision	(161)	(246)	(249)
Net interest income after loan loss provision	\$ 2,665	\$ 1,973	\$ 714
Yield on net interest earning assets after loan loss provision	27.31%	20.48%	6.80%

During 2000, we issued \$13,222,000 of CMO borrowings at a discount of \$2,013,000 for net proceeds before expenses of \$11,209,000. The Hanover 2000-A CMO security carries a fixed interest rate of 6.50%. The Hanover 2000-A security was collateralized by \$25,588,000 principal balance of the retained portions of Hanover's previous CMO borrowings, Hanover 98-A, Hanover 99-A and Hanover 99-B and certain retained MBS from Hanover 98-B. Our total investment in Hanover 98-B private placement MBS at December 31, 2002 includes a \$10,937,000 investment in six investment-grade notes ("AA", "A" and "BBB"), six interest-only notes, six below-investment-grade notes and three principal-only notes. However, we classify the investment-grade and below-investment-grade notes as CMO collateral and the interest-only and principal-only notes as private placement MBS.

For Hanover 2000-A, we record 100% of the interest income, net of servicing and other fees, generated by the mortgage loans underlying this transaction. In accordance with accounting principles generally accepted in the United States of America, Hanover 2000-A is recorded as a financing transaction. The primary source of financing for these mortgage loans is the CMO borrowing. This financing represents the liability for certain investment-grade mortgage notes issued by us. The interest expense on this financing represents the coupon interest amount to be paid to the note holders.

Our net equity in these transactions was leveraged through reverse repurchase agreement financing. In a reverse repurchase financing, we sell a pool of assets but agree to repurchase them at a set time in the future. At December 31, 2002, we had \$1,698,000 of reverse repurchase agreement financing against our net equity in these transactions.

Interest expense includes the interest on CMO borrowings, interest on the related reverse repurchase agreements and amortization of certain deferred financing costs and interest rate caps.

Agency-issued MBS

Net interest income generated from investments in Agency-issued MBS is as follows (dollars in thousands):

	Years Ended December 31,		
	2002	2001	2000
Average asset balance	\$ 7,186	\$ 15,401	\$ 41,072
Average reverse repurchase agreement borrowing balance	6,410	9,732	29,020
Net interest earning assets	776	5,669	12,052
Average leverage ratio	89.20%	63.19%	70.66%
Effective interest income rate	6.70%	7.98%	7.28%
Effective interest expense rate	3.32%	6.40%	5.71%
Net interest spread	3.38%	1.58%	1.57%
Interest income	\$ 481	\$ 1,229	\$ 2,989
Interest expense	213	623	1,659
Net interest income before loan loss provision	268	606	1,330
Loan loss provision	--	--	--
Net interest income after loan loss provision	\$ 268	\$ 606	\$ 1,330
Yield on net interest earning assets after loan loss provision	34.56%	10.70%	11.04%

During 2002, we purchased \$30.0 million of Agency-issued securities and sold \$53.4 million. During 2001, we purchased \$125.8 million of Agency-issued securities and sold \$98.3 million. In November 2000, we purchased \$1.9 million of GNMA securities. In December 2000, we sold thirty-one FNMA Certificates, totaling \$36.9 million of principal.

Interest expense includes the interest on the related reverse repurchase agreements and amortization of deferred financing costs and interest rate caps.

Private Placement MBS

Net interest income generated from private placement MBS excluding securities pledged as collateral for CMOs is as follows (dollars in thousands):

	Years Ended December 31,		
	2002	2001	2000
Average asset balance	\$ 14,257	\$ 14,676	\$ 20,266
Average reverse repurchase agreement borrowing balance	6,128	6,085	7,544
Net interest earning assets	8,129	8,591	12,722
Average leverage ratio	42.98%	41.46%	37.23%
Effective interest income rate	16.76%	20.26%	19.93%
Effective interest expense rate	3.42%	6.86%	7.81%
Net interest spread	13.34%	13.40%	12.12%
Interest income	\$ 2,389	\$ 2,974	\$ 4,039
Interest expense	210	418	589
Net interest income before loan loss provision	2,179	2,556	3,450
Loan loss provision	(232)	(463)	(626)
Net interest income after loan loss provision	\$ 1,947	\$ 2,093	\$ 2,824
Yield on net interest earning assets after loan loss provision	23.95%	24.37%	22.19%

The Private Placement MBS category includes:

- interest-only and principal-only notes that we issued in our second securitization, Hanover 1998-B, and
- starting in June 1999, subordinate MBS that we purchased in the open market.

The 1998-B interest-only notes are adversely affected more than other notes by higher than expected prepayment speeds on underlying mortgage loans with interest rates in excess of the pass through rate on the securitization. Generally, mortgages with higher interest rates will be repaid more rapidly than mortgages with lower interest rates.

Our investment in private placement MBS at December 31, 2002 includes an investment of \$0.6 million carrying value in 1998-B interest-only notes, an investment of \$0.6 million carrying value in 1998-B principal-only notes and an investment of \$13.0 million carrying value in below-investment-grade subordinate MBS classified as held to maturity, available for sale or trading.

During 2002, we purchased \$23.3 million of below-investment-grade MBS from third parties and sold \$16.3 million of below-investment-grade MBS to third parties.

During 2001, we purchased \$16.4 million of below-investment-grade MBS from third parties and sold \$34.6 million of below-investment-grade MBS to third parties.

During 2000, Hanover purchased \$6.0 million of below-investment-grade MBS from third parties, sold \$5.9 million of below-investment-grade MBS to third parties, purchased \$13.8 million of below-investment-grade subordinate MBS from HCP, and transferred \$9.9 million of investment-grade and below-investment-grade subordinate MBS from Hanover's 1998-B CMO to Collateral for the 2000-A CMO.

Other Interest Income

Interest income from non-mortgage assets is as follows (dollars in thousands):

	Years Ended December 31,		
	2002	2001	2000
Overnight investing	\$ 116	\$257	\$124
Related party notes	752	612	532
Eliminations	(251)	--	--
	\$ 617	\$869	\$656

Gain on Sale and Mark to Market of Mortgage Assets

Our 2002 results include a gain on sale of mortgage assets of \$2,095,000 compared to \$3,782,000 for 2001 and \$819 for 2000. No adjustments were required on a pro forma basis because gain on sale of mortgage assets relates only to Hanover during these periods. We cannot assure you that we will be able to recognize gain on sale in the future. As a REIT, we do not actively trade our mortgage assets.

Our purchased subordinate MBS portfolio is primarily comprised of non-investment-grade securities. These securities are generally purchased at a substantial discount to their principal balance to reflect their inherent credit risk. To the extent that actual losses on the mortgage asset are less than the discount, the discount provides a yield enhancement. We seek to reduce credit risk by actively monitoring our portfolio for delinquency trends and due to such monitoring we may, from time to time, decide to sell a security in order to mitigate potential losses.

When we classified mortgage assets as trading securities during 2002, 2001 and 2000, we recognized mark to market gains or losses through our Consolidated Statement of Income. Mortgage assets classified as available for sale are marked to market through other comprehensive income. We recognized mark to market gains on our purchased subordinate MBS portfolio of \$1,780,000 in 2002 as compared to \$792,000 in 2001 and \$49,000 in 2000. Market gains on our purchased subordinate portfolio are primarily subject to assumptions on the underlying mortgage loan portfolio including, but not limited to, prepayment speed assumptions, future loss assumptions and changes in the benchmark interest rate.

Other Revenue

Revenues from loan brokering, trading and advisory services increased to \$2,686,000 in 2002, from \$0 for 2001 and 2000. Revenues from due diligence increased to \$2,891,000 in 2002 from \$0 for 2001 and 2000. Revenues from assignment fees increased to \$1,387,000 in 2002 from \$0 for 2001 and 2000. In each case, this is because in periods prior to the consolidation of Hanover, HCP, HT and HCP-2, we did not separately record revenues attributable to HT, HCP, or HCP-2, and all of the revenues listed in this paragraph are derived from the activities of HT and HCP.

On a pro forma basis, revenues from loan brokering, trading and advisory services increased to \$6,831,000 in 2002, from \$3,521,000 for 2001. This is primarily attributable to revenue derived from a contract with the FDIC during 2002 and revenue generated by third quarter 2002 whole-loan sales. We cannot assure you that comparable contracts will be available in the future. On a pro forma basis, revenues from due diligence decreased to \$4,971,000 in 2002 from \$5,083,000 in 2001. Although total due diligence revenues decreased, our revenue from our largest clients increased and our number of clients increased. On a pro forma basis, revenues from assignment fees increased to \$2,220,000 in 2002 from \$757,000 for 2001, primarily because of 2 large assignment contracts. These contracts account for 74% of the total assignment fees recognized in 2002. We cannot assure you that we will be able to generate assignment fees comparable to those recorded for 2002.

Operating Expenses

Years Ended December 31, 2002 and 2001

Operating expenses in 2002 were \$11,473,000 compared to \$3,696,000 as previously reported for 2001. Pro forma operating expenses were \$17,805,000 in 2002 compared to \$15,987,000 for the same period last year on a pro forma basis. The biggest component of the increase, on a pro forma basis, was an increase in personnel expenses. Personnel expenses for 2002, on a pro forma basis, increased to \$8,907,000 compared to, on a pro forma basis, \$7,231,000 for the same period last year. The increase in personnel expenses was primarily due to (i) a bonus accrual established for a pool of employees during 2002 that was established pursuant to existing contractual agreements; no such bonus accrual was established in 2001, and (ii) an increase in commission expense, primarily relating to the increase in loan brokering, trading and advisory services of \$459,000 in 2002 as compared to the prior year. The increase in personnel expense was partially offset by a decrease in legal and professional fees to \$1,206,000 on a pro forma basis in 2002, from \$1,704,000 on a pro forma basis for the same period last year. Legal and professional fees decreased in 2002 primarily due to non-recurring charges in 2001.

Years Ended December 31, 2001 and 2000

Operating expenses in 2001 were \$3,696,000 compared to \$3,136,000 in 2000, an increase of \$560,000. Personnel expenses decreased to \$680,000 in 2001 from \$1,020,000 in 2000. Hanover billed personnel-related expenses totaling \$345,000 to HT and \$425,000 to HCP in 2001 compared to \$369,000 and \$136,000 in 2000. Legal and professional fees increased to \$1,247,000 in 2001 from \$555,000 in 2000 as a result of an increase in audit, tax and consulting fees due to an increased scope of services and, to a lesser extent, professional fees incurred as a result of our consideration of a corporate restructure. Financing fees declined to \$246,000 in 2001 from \$281,000 in 2000 reflecting reduced committed lines of credit and lower levels of activity.

Equity in Income (Loss) of Unconsolidated Subsidiaries

Years Ended December 31, 2002 and 2001

HDMF-I is a limited liability company whose objective is to purchase, service and manage pools of primarily sub- and non-performing one-to-four family residential whole loans. In November 2001, we made our initial investment in HDMF-I of \$115,000 to fund our proportionate share of professional, organizational and other fees of HDMF-I. In the first quarter of 2002, we invested an aggregate of \$3,891,000 in HDMF-I to fund our proportionate share of a loan pool with a purchase price of \$12,230,000. In the second half of 2002, we invested an additional \$1,968,000 in HDMF-I to fund the purchase price of an additional loan pool and received \$1,458,000 in distributions from HDMF-I. For 2002 we recognized equity in income of \$157,000 and for the comparable period in 2001, we recognized equity in losses of \$35,000. At December 31, 2002, we had a total capital contribution commitment of \$5,820,000.

Years Ended December 31, 2001 and 2000

As discussed above, Hanover acquired all of the outstanding capital stock of HCP and HT on July 1, 2002. As a result, we did not record equity in income (loss) of HCP and HT for the full year of 2002.

Hanover's equity in income of HCP declined to \$43,000 in 2001 from \$455,000 in 2000. Total revenue at HCP decreased \$2,132,000 or 24% to \$6,582,000 in 2001 from \$8,714,000 in 2000, primarily due to the termination of subordinate MBS activity in 2000. The portfolio of subordinate MBS contributed \$954,000 of revenue including gains on sale of \$441,000 in 2000. This portfolio was transferred from HCP to Hanover in July of 2000. Due diligence fees decreased \$1,213,000 or 17% to \$5,803,000 in 2001 from \$7,016,000 in 2000 primarily due to contracts awarded in 2000 for which no comparable revenue was earned in 2001. Assignment fees increased \$126,000 or 20% to \$757,000 in 2001 from \$631,000 in 2000 primarily due to the assumption of assignment contracts and employees of a former competitor. Loan brokering and asset management fees contributed \$30,000 in 2000, this activity was transferred to HT in July of 2000.

Hanover recognized equity in losses of HT of \$3,263,000 in 2001 compared to \$1,495,000 in 2000. HT recorded revenue of \$3,599,000 and \$141,000 in 2001 and 2000. HT operating expenses for 2001 and 2000 totaled \$6,962,000 and \$1,683,000. Personnel expenses increased to \$3,617,000 in 2001 from \$790,000 in 2000. Technology expense for web hosting and web graphics increased to \$664,000 in 2001 from \$231,000 in 2000. Premises expense increased to \$326,000 in 2001 from \$130,000 in 2000. Depreciation and amortization increased to \$1,102,000 in 2001 from \$151,000 in 2000. As HT commenced operations in 1999, much of 2000 and 2001 was spent developing HT's proprietary Internet exchange for trading mortgage loans, mortgage servicing rights and related assets. HT recorded minimal revenues in 2000.

The table below highlights our historical quarterly trends and components of return on average equity for 2000, 2001 and 2002.

For the Quarters Ended	Net Interest Income/ Equity	Gain on Sale and Mark to Market of Mortgage Assets/ Equity	Loan Brokering/ Trading, Due Diligence Fees and Other Income (Loss)/ Equity	Operating Expenses/ Equity	Equity in Income (Loss) of Subsidiaries/ Equity	Income Tax Provision (Benefit)/Equity	Annualized Return on Equity
March 31, 2000	10.91%	1.57%	--	7.74%	0.71%	--	5.45%
June 30, 2000	10.99%	2.62%	--	7.95%	0.43%	--	6.09%
September 30, 2000	13.40%	--	1.16%	4.31%	(4.01%)	--	6.24%
December 31, 2000	12.43%	6.61%	--	6.24%	(6.41%)	--	6.39%
March 31, 2001	10.10%	8.51%	0.43%	6.54%	(6.27%)	--	6.23%
June 30, 2001	14.05%	8.43%	--	7.46%	(8.37%)	--	6.65%
September 30, 2001	13.97%	11.05%	--	10.85%	(7.24%)	--	6.93%
December 31, 2001	14.66%	15.04%	(0.27%)	10.25%	(9.01%)	--	10.18%
March 31, 2002	15.13%	8.29%	(1.63%)	9.91%	0.54%	--	12.43%
June 30, 2002	11.94%	5.50%	(2.30%)	8.76%	6.27%	--	12.65%
September 30, 2002	12.96%	15.54%	26.42%	42.53%	1.18%	(0.06%)	13.63%
December 31, 2002	12.45%	2.45%	37.65%	43.77%	0.26%	0.52%	8.52%

Notes: Average equity excludes unrealized loss on investments available for sale.

Prior to July 1, 2002, the financial results for HCP, HT and HCP-2 are included in equity in income/(loss) of unconsolidated subsidiaries. For periods ending after June 30, 2002, these entities' results are consolidated with Hanover's and their results will appear throughout our financial statements as applicable, rather than in a single line-item.

TAXABLE INCOME

Our taxable income for the year ended December 31, 2002 is estimated at \$565,000. Taxable income differs from GAAP net income for the year ended December 31, 2002 due to various recurring and one-time book/tax differences. The following table details the major book/tax differences in arriving at the estimated taxable income for the year ended December 31, 2002 (dollars in thousands):

GAAP net income	\$ 5,138
GAAP gain on sale	(2,028)
Tax gain on sale	1,950
Utilization of capital loss carryforward	(1,950)
Income of subsidiaries not included in taxable income	(362)
Gain on mark to market of mortgage securities, net of associated hedge	(1,066)
Loan loss provision, net of realized losses	(1)
Tax amortization of net premiums on mortgages, CMO collateral and mortgage securities and interest accrual in excess of GAAP amortization and interest accrual	(256)
Deduction for tax for exercise of non-qualified stock options	(888)
Other	28
Estimated taxable income	\$ 565

As a REIT, we are required to pay dividends amounting to 85% of each year's taxable ordinary income and 95% of the portion of each year's capital gain net income that is not taxed at the REIT level, by the end of

each calendar year and to have declared dividends amounting to 90% of our REIT taxable income for each year by the time we file our Federal tax return. Therefore, a REIT generally passes through substantially all of its earnings to shareholders without paying Federal income tax at the corporate level. For the year ended December 31, 2002, a portion of dividends paid to shareholders was deemed to be a return of capital for income tax purposes.

LIQUIDITY

We expect to meet our future short-term and long-term liquidity requirements generally from our existing working capital, cash flow provided by operations, reverse repurchase agreements and other possible sources of longer-term financing, including CMOs and REMICs. We consider our ability to generate cash to be adequate to meet operating requirements both in the short-term and the long-term. However, we have exposure to market-driven liquidity events due to the short-term reverse repurchase financing we have in place against our MBS. If a significant decline in the market value of our portfolio should occur, our available liquidity from existing sources and ability to access additional sources of credit could be reduced. As a result of such a reduction in liquidity, we may be forced to sell certain investments or incur debt to maintain liquidity. If required, these sales could be made at prices lower than the carrying value of such assets, which could result in losses. At December 31, 2002, we had one committed reverse repurchase line of credit with \$10 million available and four uncommitted lines of credit. We may seek to establish additional committed and uncommitted lines of credit in the future. We cannot assure you that we will be successful in obtaining such additional financing on favorable terms, if at all.

Net cash provided by operating activities for the year ended December 31, 2002 was \$24,994,000 compared to net income of \$5,138,000 for the year. Sales of trading securities provided \$65,497,000, partially offset by the purchase of trading securities of \$41,287,000.

Net cash provided by investing activities amounted to \$55,782,000 during the year ended December 31, 2002. The majority of cash proceeds from investing activities was generated from (i) principal payments received on collateral for CMOs of \$48,837,000, (ii) proceeds from sale of mortgage assets of \$10,197,000 and (iii) principal payments received on mortgage securities of \$4,446,000. These proceeds were partially offset by capital contributions to HDMF-I of \$5,859,000 and purchase of mortgage securities of \$4,866,000.

Cash flows from financing activities used \$79,117,000 during the year ended December 31, 2002. We made repayments on CMO borrowings of \$48,526,000 and on reverse repurchase agreements of \$27,055,000. We also paid dividends of \$4,218,000 and purchased an additional 15,666 shares of our common stock for \$132,000 during the year. These payments were partially offset by proceeds from the exercise of stock options resulting in the issuance of 185,610 shares of common stock for \$814,000.

CAPITAL RESOURCES

We regularly invest our capital in MBS through Hanover, our primary investment vehicle. We have also invested a limited amount of Hanover's capital in HT. From the inception of HT in May 1999 until December 31, 2002, Hanover advanced \$7,396,000 in the form of loans, and \$173,000 in the form of short-term advances, to HT. On July 1, 2002, Hanover acquired 100% of the outstanding common stock of each of HT, HCP and HCP-2; for periods ending after June 30, 2002, Hanover's financial statements will be consolidated with the financial statements of those entities. Although we have no immediate plans for a change in the ownership of HT, we continue to pursue third-party investments to address HT's future capitalized software budget and operating needs. If outside financing is not located, we will continue to be responsible for HT's capital and operating requirements, although we do not expect those needs to be substantial in 2003.

RISK FACTORS

The following is a summary of the risk factors that we currently believe are important and that could cause our results to differ from expectations. This is not an exhaustive list; other factors not listed below could be material to our results. If any of the risks discussed below actually occur, our business, operating results, prospects or financial condition could be harmed.

REIT Requirements

Hanover has elected to be taxed as a REIT under the Code. We believe that we were in full compliance with the REIT tax rules as of December 31, 2002 and intend to remain in compliance with all REIT tax rules. If we fail to qualify as a REIT in any taxable year and certain relief provisions of the Code do not apply, we will be subject to Federal income tax as a regular, domestic corporation, and our stockholders will be subject to tax in the same manner as stockholders of a regular corporation. Distributions to our stockholders in any year in which we fail to qualify as a REIT would not be deductible by us in computing our taxable income. As a result, we could be subject to income tax liability, thereby significantly reducing or eliminating the amount of cash available for distribution to our stockholders. Further, we could also be disqualified from re-electing REIT status for the four taxable years following the year during which we became disqualified. At the same time, complying with REIT requirements may limit our ability to hedge our risks, or enter into otherwise attractive investments.

Investments in Certain Mortgage Assets

We take certain risks in investing in non-standard, single-family mortgage loans and securities collateralized by such loans. If these mortgage loans are missing relevant documents, such as the original note, they may be difficult to enforce. These mortgage loans may also have inadequate property valuations. In addition, if a single-family mortgage loan has a poor payment history, it is more likely to have future delinquencies because of poor borrower payment habits or a continuing cash flow problem.

Credit Risk

In conducting our business, we retain credit risk primarily through (i) the purchase of subordinate mortgage securities, (ii) the retention of subordinate securities from our own securitization transactions, (iii) the direct investment in mortgage loans on our own behalf and (iv) investment in HDMF-I. Through these investing activities, we generally bear the credit losses on the related pools of mortgage loans up to their carrying value. During the time we hold mortgage assets for investment, we are subject to the risks of borrower defaults and bankruptcies and hazard losses (such as those occurring from earthquakes or floods) that are not covered by insurance. If a default occurs on any mortgage loan held by us or on any mortgage loan collateralizing below-investment-grade MBS held by us, we will bear the risk of loss of principal to the extent of any deficiency between the value of the mortgaged property, plus any payments from an insurer or guarantor, and the amount owing on the mortgage loan.

As of December 31, 2002, we retain the aggregate credit risk on \$5.9 billion of mortgage loans relating to:

	Principal Balance	Carrying Value	Financing
	-----	-----	-----
Subordinate MBS	\$ 23,707	\$14,098	\$4,585
Collateral for CMOs	115,128	9,967	1,698
Mortgage Loans	547	413	--
	-----	-----	-----
Total	\$139,382	\$24,478	\$6,283
	=====	=====	=====

The above carrying value of collateral for CMOs is our net invested equity in retained mortgage-backed bonds.

In addition, HDMF-I retains the aggregate credit risk on \$9,264,000 of mortgage loans of which our portion is \$4,638,000 of invested capital at risk.

If we were to invest in commercial mortgage loans, we may be subject to certain additional risks. Commercial properties tend to be unique and more difficult to value than single-family residential properties. Commercial mortgage loans often have shorter maturities than single-family mortgage loans and often have a significant principal balance or "balloon" due on maturity. A balloon payment creates a

greater risk for the lender because the ability of a borrower to make a balloon payment normally depends on its ability to refinance the loan or sell the related property at a price sufficient to permit the borrower to make the payment. Commercial mortgage lending is generally viewed as exposing the lender to a relatively greater risk of loss than single-family mortgage lending because it usually involves larger mortgage loans to single borrowers or groups of related borrowers and the repayment of the loans is typically dependent upon the successful operation of the related properties. As of December 31, 2002, we did not have any commercial mortgage loan investments. However, we may elect to make such investments in the future.

Geographic Concentration

Although we do not set specific geographic diversification requirements for our portfolio, we do monitor the geographic dispersion of our assets. Concentration in any one geographic area will increase our exposure to the economic and natural hazard risks associated with that area.

Negative Effects of Fluctuating Interest Rates

Changes in interest rates may impact our earnings in various ways. Approximately one third of our mortgage loans held as collateral for CMOs are adjustable rate mortgages ("ARMs") and approximately 5% of our MBS are collateralized by ARM loans. Therefore, rising short-term interest rates may negatively affect our earnings in the short term. Increases in the interest rate on an ARM loan are generally limited to either 1% or 2% per adjustment period. ARM loans owned by us or underlying our MBS are subject to such limitations, while adjustments in the interest rate on our borrowings are not correspondingly limited. As a result, in periods of rising interest rates, our net interest income could decline.

The rate of prepayment on our mortgage assets may increase if interest rates decline or if the difference between long-term and short-term interest rates diminishes. Increased prepayments would cause us to amortize any premiums paid on the acquisition of our mortgage assets faster than currently anticipated, resulting in a reduced yield on our mortgage assets. Additionally, to the extent proceeds of prepayments cannot be reinvested at a rate of interest at least equal to the rate previously earned on the prepaid mortgage assets, our earnings may be adversely affected.

Insufficient Demand for Mortgage Loans and our Loan Products

The availability of mortgage loans that meet our criteria depends on, among other things, the size of and level of activity in the residential, multifamily and commercial real estate lending markets. The size and level of activity in these markets, in turn, depends on the level of interest rates, regional and national economic conditions, inflation and deflation in property values and the general regulatory and tax environment as it relates to mortgage lending. If we cannot obtain sufficient mortgage loans or mortgage securities that meet our criteria, our business will be adversely affected.

Investment in Subsidiary

As of December 31, 2002, Hanover advanced \$7,396,000 to HT in the form of loans. We anticipate that HT will not need substantial capital investments to fund operating activities in 2003. In addition, we are currently attempting to raise outside capital to address HT's capitalized software budget and operating needs. HT has a limited operating history and has not been profitable to date.

Investment Company Act

At all times, we intend to conduct our business so as not to become regulated as an investment company under the Investment Company Act of 1940, as amended. If we were to become regulated as an investment company, our use of leverage would be substantially reduced. The Investment Company Act exempts entities that are "primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on interest in real estate" ("Qualifying Interests"). Under current interpretation of the staff of the Securities and Exchange Commission, to qualify for this exemption, we must maintain at least 55% of our assets directly in Qualifying Interests. As of December 31, 2002, we believe that we are in compliance with this requirement.

State and Local Taxes

Our shareholders may be subject to state or local taxation in various jurisdictions, including those in which we transact business or where the shareholders reside. The state and local tax treatment of our shareholders may not conform to Federal income tax consequences discussed above. Consequently, prospective shareholders should consult their own tax advisors regarding the effect of state and local tax laws on an investment in our shares.

Available Credit

Our ability to meet our performance goals depends on our access to borrowed funds in sufficient amounts and on favorable terms. If we are not able to renew or replace maturing borrowings, we might have to sell some or all of our assets, possibly under adverse market conditions, terminate hedge positions, and/or pledge additional collateral to our existing lenders.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

We use certain derivative financial instruments as hedges of anticipated transactions relating to our mortgage securities.

From time to time, we enter into forward sales of mortgage securities issued by federal agencies to manage our exposure to market pricing changes in connection with the purchase, holding, securitization and sale of our fixed-rate mortgage loan portfolio and other mortgage securities. We generally close out the hedge position to coincide with the related sale or securitization transaction. As such hedges are considered freestanding derivatives for accounting purposes, we recognize changes in the fair value of such hedges in earnings in the period of change.

At December 31, 2002, we had one forward commitment to sell \$4.5 million (par value) and one forward commitment to buy \$4.5 million of agency-issued mortgage securities that had not yet settled. These forward commitments were entered into to partially hedge the expected sale of approximately \$3.4 million principal balance of subordinate MBS classified as trading. At December 31, 2002, the fair value of our forward sale of agency-issued MBS was (\$46,000). If interest rates decreased 300 basis points, our maximum projected loss exposure would be an additional (\$47,000); conversely, if interest rates increased 300 basis points, our maximum projected gain would be \$509,000.

The primary risk associated with short-selling agency-issued securities relates to changes in interest rates. Generally, as market interest rates increase, the market value of the hedged asset (fixed-rate mortgage loans) will decrease. The net effect of increasing interest rates will generally be a favorable or gain settlement on the forward sale of the agency-issued security; this gain should offset a corresponding decline in the value of the hedged assets. Conversely, if interest rates decrease, the market value of the hedged asset will generally increase. The net effect of decreasing interest rates will generally be an unfavorable or loss settlement on the forward sale of the agency-issued security; this loss should be offset by a corresponding gain in value of the hedged assets. To mitigate interest rate risk, an effective matching of agency-issued securities with the hedged assets needs to be monitored closely. Senior management monitors the changes in weighted average duration and coupons of the hedged assets and will appropriately adjust the amount, duration and coupon of future forward sales of agency-issued securities.

We also enter into interest rate caps to manage our interest rate exposure on certain reverse repurchase financing and floating rate CMOs. For interest rate caps designated as freestanding derivatives for accounting purposes, changes in fair value are recognized in earnings in the period of change.

During the first quarter of 2002, we terminated hedge accounting for one of our cash flow hedges. At the termination date, the loss previously reported in other comprehensive income of \$164,000 was reclassified through earnings. We then designated this interest rate cap as a freestanding derivative.

At December 31, 2002, we had the following interest rate caps in effect (dollars in thousands):

NOTIONAL AMOUNT	INDEX	STRIKE %	MATURITY DATE	ACCOUNTING DESIGNATION
\$ 11,000	3 Month LIBOR	7.695%	October 2003	Freestanding Derivative
20,000	1 Month LIBOR	7.75%	August 2004	Freestanding Derivative
\$ 31,000				

The primary risk associated with interest rate caps relates to interest rate increases. The interest rate caps provide a cost of funds hedge against interest rates that exceed the strike rate, subject to the limitation of the notional amount of financing. At December 31, 2002, the fair value of our interest rate caps was \$1,000; also the maximum potential loss exposure due to unfavorable market movements.

INTEREST RATE SENSITIVITY

Interest Rate Mismatch Risk - Reverse Repurchase Financing

At December 31, 2002, we owned \$413,000 of mortgage loans held for sale. In general, we expect that future loan purchases will be conducted by HDMF-I, and we do not currently plan to purchase additional loans for our own account. If we resume our strategy of purchasing mortgage loans for our own account, we would finance these assets during the initial period (the time period during which management analyzes the loans in detail and corrects deficiencies where possible before securitizing the loans) with reverse repurchase agreement financing or with equity. In this scenario, we would be exposed to the mismatch between the cost of funds on our reverse repurchase agreement financing and the yield on the mortgage loans. Our reverse repurchase agreement financing at December 31, 2002 was indexed to LIBOR plus a spread of 40 to 200 basis points. This financing generally is rolled and matures every 30 to 90 days. Accordingly, any increases in LIBOR will tend to reduce net interest income and any decreases in LIBOR will tend to increase net interest income.

We also have floating-rate reverse repurchase financing for certain fixed-rate MBS. At December 31, 2002, we had a total of \$4,585,000 of floating-rate reverse repurchase financing compared to \$7,008,000 of fixed-rate MBS investments. We have attempted to hedge this exposure by using the interest rate caps described above.

Price Risk

The market value of mortgage loans and mortgage securities will fluctuate with changes in interest rates. In the case of mortgage loans held for sale and mortgage securities available for sale or held for trading, we will be required to record changes in the market value of such assets. In the case of mortgage loans held for sale and mortgage securities held for trading, we generally attempt to hedge these changes through the short sale of mortgage securities, described above. At December 31, 2002, we did not have any significant mortgage loans held for sale. We hedge the mortgage securities held for trading with the short sale of mortgage securities described above.

Prepayment Risk

Interest income on the mortgage loan and mortgage securities portfolio is also negatively affected by prepayments on mortgage loan pools or MBS purchased at a premium and positively impacted by prepayments on mortgage loan pools or MBS purchased at a discount. We assign an anticipated prepayment speed to each mortgage pool and MBS at the time of purchase and record the appropriate amortization of the premium or discount over the estimated life of the mortgage loan pool or MBS. To the extent the actual prepayment speeds vary significantly from the anticipated prepayment speeds for an extended period of time, we will adjust the anticipated prepayment speeds and amortization of the premium or discount accordingly. This will negatively (in the case of accelerated amortization of premiums or decelerated amortization of discounts) or positively (in the case of decelerated amortization of premiums or accelerated amortization of discounts) impact net interest income.

Securitized Mortgage Loan Assets

With respect to the matched funding of assets and liabilities, the CMO collateral relating to the 1998-A, 1999-A, 1999-B and 2000-A securitizations reflect \$71,732,000 of fixed-rate mortgage loans and \$31,019,000 of adjustable-rate mortgage loans and \$9,805,000 of mortgage securities at December 31, 2002. The primary financing for this asset category is the CMO debt of \$102,589,000 and reverse repurchase agreements of \$1,698,000. The reverse repurchase agreement financing, which is indexed to LIBOR, is subject to interest rate volatility as the reverse repurchase agreement matures and is extended. The financing provided by the CMOs for the 1998-A, 1999-A and 2000-A securitizations lock in long-term fixed financing and thereby eliminates most interest rate risk. The financing for the 1999-B securitization is indexed to LIBOR. Accordingly, we have hedged this interest rate risk through the purchase of interest

rate caps. We purchased amortizing interest rate caps with notional balances of \$110 million in August 1999 to hedge the 1999-B securitization. The remaining notional balance of these caps is \$20 million at December 31, 2002.

Mortgage Securities

At December 31, 2002, we owned certain fixed-rate and adjustable-rate private placement mortgage securities and certain interest-only and principal-only private placement mortgage securities with an aggregate carrying value of \$14,098,000. The coupon interest rates on the fixed-rate mortgage securities would not be affected by changes in interest rates. The interest-only notes remit monthly interest generated from the underlying mortgages after deducting all service fees and the coupon interest rate on the applicable notes. The interest rate on each of the interest-only notes is based on a notional amount (the principal balance of those mortgage loans with an interest rate in excess of the related note coupon interest rate). The notional amounts decline each month to reflect the related normal principal amortization, curtailments and prepayments for the related underlying mortgage loans. Accordingly, net interest income on the mortgage securities portfolio would be negatively affected by prepayments on mortgage loans underlying the mortgage securities and would further be negatively affected to the extent that higher rated coupon mortgage loans paid off more rapidly than lower rated coupon mortgage loans.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Our financial statements and related notes, together with the Independent Auditors' Report thereon beginning on page F-1 of this Form 10-K.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Incorporated herein by reference to our definitive proxy statement for the 2003 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission within 120 days after the end of our fiscal year.

ITEM 11. EXECUTIVE COMPENSATION

Incorporated herein by reference to our definitive proxy statement for the 2003 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission within 120 days after the end of our fiscal year.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

(a) Security Ownership of Certain Beneficial Owners and Management

Incorporated herein by reference to our definitive proxy statement for the 2003 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission within 120 days after the end of our fiscal year.

(b) Securities Authorized for Issuance under Equity Compensation Plans

The following table sets forth information regarding outstanding options and shares reserved for future issuance under our equity compensation plans as of December 31, 2002. None of the plans have outstanding warrants or rights other than options.

EQUITY COMPENSATION PLAN INFORMATION

Plan Category	Number of Securities to be Issued upon Exercise of Outstanding Stock Options	Weighted Average Exercise Price of Outstanding Stock Options	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders(1)	250,824	\$15.283	74,509
Equity compensation plans not approved by security holders	258,035	\$ 4.216	44,167

(1) A Bonus Incentive Compensation Plan has been established for eligible participants of the Company. Although the annual bonus is payable one-half in cash and one-half in shares of our common stock, no shares have been reserved for future issuance.

Under our 1999 Equity Incentive Plan, the Compensation Committee can grant non-qualified stock options or restricted stock to executive officers, employees, directors, agents, advisors and consultants of Hanover and its subsidiaries. Subject to anti-dilution provisions for stock splits, stock dividends and similar events, the Plan authorizes the grant of options to purchase, and awards of, an aggregate of up to 550,710 shares of our common stock. The Compensation Committee has the authority to amend the Plan and to set the terms of all awards granted under the Plan, including the number of shares of common stock awarded, the exercise price and vesting provisions. The Plan provides for option grants upon initial election and subsequent re-election to the Board of Directors for each non-employee director, exercisable into 2,000 shares of our common stock which vest in full on the grant date. If an option granted under the Plan expires or terminates, or an award is forfeited, the shares subject to any unexercised portion of such option or award will again become available for the issuance of additional options or awards under the Plan. No eligible participant can be granted options exercisable into, or awards of, more than 50,000 shares of our common stock in any year. In the event of a change of control in which we are not the surviving entity, the Compensation Committee can accelerate the vesting of all outstanding awards. The Plan will expire in 2009, but awards granted prior to the expiration of the Plan may be exercisable beyond that date.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Incorporated herein by reference to our definitive proxy statement for the 2003 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission within 120 days after the end of our fiscal year.

ITEM 14. CONTROLS AND PROCEDURES

(a) Within the 90 days prior to the date of this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-14 under the Securities Exchange Act of 1934, as amended. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective in timely alerting them to material information required to be included in our periodic SEC filings. However, we cannot assure you that our controls and procedures can prevent or detect all errors and fraud. In addition, since any system

of controls is based in part upon assumptions regarding future events, we cannot assure you that the design of our controls will be successful in achieving its stated goals under all potential future conditions.

- (b) There have been no significant changes in our internal controls or in other factors that could significantly affect our internal controls subsequent to the date of the evaluation referred to in subsection (a) above.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENTS, SCHEDULES, AND REPORTS ON FORM 8-K

(a) (1) Financial Statements

See Part II, Item 8 hereof.

(2) Financial Statement Schedules

All schedules omitted are inapplicable or the information required is shown in the Financial Statements or notes thereto.

(3) Exhibits

Exhibits required to be attached by Item 601 of Regulation S-K are listed in the Exhibit Index attached hereto, which is incorporated herein by this reference.

(b) Reports on Form 8-K

We did not file any current reports on Form 8-K during the last quarter of 2002.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on March 28, 2003.

HANOVER CAPITAL MORTGAGE HOLDINGS, INC.

By /s/ J. Holly Loux

J. Holly Loux
Chief Financial Officer
(Principal Financial and
Accounting Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of Registrant and the capacities indicated on March 28, 2003.

SIGNATURE	TITLE
/s/ John A. Burchett ----- John A. Burchett	Chairman of the Board of Directors, President and Chief Executive Officer
/s/ Irma N. Tavares ----- Irma N. Tavares	Senior Managing Director and a Director
/s/ Joyce S. Mizerak ----- Joyce S. Mizerak	Senior Managing Director, Secretary and a Director
/s/ George J. Ostendorf ----- George J. Ostendorf	Senior Managing Director and a Director
/s/ John A. Clymer ----- John A. Clymer	Director
/s/ Joseph J. Freeman ----- Joseph J. Freeman	Director
/s/ James F. Stone ----- James F. Stone	Director
/s/ Saiyid T. Naqvi ----- Saiyid T. Naqvi	Director
/s/ John N. Rees ----- John N. Rees	Director
/s/ J. Holly Loux ----- J. Holly Loux	Chief Financial Officer (Principal Financial and Accounting Officer)

CERTIFICATIONS

I, John A. Burchett, certify that:

1. I have reviewed this Annual Report on Form 10-K of Hanover Capital Mortgage Holdings, Inc.;
2. Based on my knowledge, this Annual 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 Annual Report;
3. Based on my knowledge, the financial statements, and other financial information included in this Annual 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 Annual Report;
4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the Registrant and have:
 - (a) designed such disclosure controls and procedures 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 Annual Report is being prepared;
 - (b) evaluated the effectiveness of the Registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this Annual Report (the "Evaluation Date"); and
 - (c) presented in this Annual Report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation, 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 in the design or operation of internal controls which could adversely affect the Registrant's ability to record, process, summarize and report financial data and have identified for the Registrant's auditors any material weaknesses in internal controls; and
 - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal controls; and
6. The Registrant's other certifying officer and I have indicated in this Annual Report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: March 28, 2003

/s/ John A. Burchett

John A. Burchett
President and Chief Executive Officer

CERTIFICATIONS (CONTINUED)

I, J. Holly Loux, certify that:

1. I have reviewed this Annual Report on Form 10-K of Hanover Capital Mortgage Holdings, Inc.;
2. Based on my knowledge, this Annual 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 Annual Report;
3. Based on my knowledge, the financial statements, and other financial information included in this Annual 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 Annual Report;
4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the Registrant and have:
 - (a) designed such disclosure controls and procedures 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 Annual Report is being prepared;
 - (b) evaluated the effectiveness of the Registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this Annual Report (the "Evaluation Date"); and
 - (c) presented in this Annual Report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation, 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 in the design or operation of internal controls which could adversely affect the Registrant's ability to record, process, summarize and report financial data and have identified for the Registrant's auditors any material weaknesses in internal controls; and
 - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal controls; and
6. The Registrant's other certifying officer and I have indicated in this Annual Report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: March 28, 2003

/s/ J. Holly Loux

J. Holly Loux
Chief Financial Officer

EXHIBIT INDEX

EXHIBIT -----	DESCRIPTION -----
2.1*(8)	Stock Purchase Agreement dated as of July 1, 2002 by and between Registrant, John A. Burchett, Joyce S. Mizerak, George J. Ostendorf and Irma N. Tavares
3.1(9)	Amended Articles of Incorporation of Registrant, as amended
3.2(1)	Bylaws of Registrant
4.1(1)	Specimen Common Stock Certificate of Registrant
10.3*(1)	Registration Rights Agreement
10.5*(1)	Agreement and Plan of Recapitalization
10.6*(1)	Bonus Incentive Compensation Plan
10.7*(1)	1997 Executive and Non-Employee Director Stock Option Plan
10.7.1*(3)	1999 Equity Incentive Plan
10.8*(8)	Amended and Restated Employment Agreement effective as of July 1, 2002, by and between Registrant and John A. Burchett
10.8.1*(8)	Stock Option Agreement effective as of July 1, 2002 between Registrant and John A. Burchett
10.9*(8)	Amended and Restated Employment Agreement effective as of July 1, 2002, by and between Registrant and Irma N. Tavares
10.9.1*(8)	Stock Option Agreement effective as of July 1, 2002 between Registrant and Irma N. Tavares
10.10*(8)	Amended and Restated Employment Agreement effective as of July 1, 2002, by and between Registrant and Joyce S. Mizerak
10.10.1*(8)	Stock Option Agreement effective as of July 1, 2002 between Registrant and Joyce S. Mizerak
10.11*(8)	Amended and Restated Employment Agreement effective as of July 1, 2002, by and between Registrant and George J. Ostendorf
10.11.1*(8)	Stock Option Agreement effective as of July 1, 2002 between Registrant and George J. Ostendorf
10.11.2*(6)	Employment Agreement by and between Registrant and Thomas P. Kaplan

- 10.11.3* Stock Purchase Agreement as of December 13, 2002 between Thomas P. Kaplan and Hanover Capital Mortgage Holdings, Inc.
- 10.13(1) Office Lease Agreement, dated as of March 1, 1994, by and between Metroplex Associates and Hanover Capital Mortgage Corporation, as amended by the First Modification and Extension of Lease Amendment dated as of February 28, 1997.
 - 10.13.1 Second Modification and Extension of Lease Agreement dated April 22, 2002
 - 10.13.2 Third Modification of Lease Agreement dated May 8, 2002
 - 10.13.3 Fourth Modification of Lease Agreement dated November 2002
- 10.14(3) Office Lease Agreement, dated as of February 1, 1999, between LaSalle-Adams, L.L.C. and Hanover Capital Partners Ltd.
- 10.15 Office Lease Agreement, dated as of September 3, 1997, between Metro Four Associates Limited Partnership and Pamex Capital Partners, L.L.C., as amended by the First Amendment to Lease dated May 2000
- 10.25*(1) Contribution Agreement by and among Registrant, John A. Burchett, Joyce S. Mizerak, George J. Ostendorf and Irma N. Tavares
- 10.25.1*(8) Amendment No. 1 to Contribution Agreement entered into as of July 1, 2002 by and between Registrant, John A. Burchett, Joyce S. Mizerak, George J. Ostendorf and Irma N. Tavares
- 10.26*(1) Participation Agreement by and among Registrant, John A. Burchett, Joyce S. Mizerak, George J. Ostendorf and Irma N. Tavares
- 10.27*(1) Loan Agreement
- 10.29(2) Management Agreement, dated as of January 1, 1998, by and between Registrant and Hanover Capital Partners Ltd.
- 10.30(3) Amendment Number One to Management Agreement, dated as of September 30, 1999
- 10.31(4) Amended and Restated Master Loan and Security Agreement by and between Greenwich Capital Financial Products, Inc., Registrant and Hanover Capital Partners Ltd. dated March 27, 2000
 - 10.31.1(7) Amendment Number Three dated as of April 11, 2001 to the Amended and Restated Master Loan and Security Agreement dated as of March 27, 2000 by and among Registrant, Hanover Capital Partners, Ltd. and Greenwich Capital Financial Products, Inc.
 - 10.31.2 Amendment Number Five dated as of March 28, 2002 to the Amended and Restated Master Loan and Security Agreement dated as of March 27, 2000 by and among Registrant, Hanover Capital Partners, Ltd. and Greenwich Capital Financial Products, Inc.
 - 10.31.3 Amendment Number Six dated as of March 27, 2003 to the Amended and Restated Master Loan and Security Agreement dated as of March 27, 2000 by and among Registrant, Hanover Capital Partners, Ltd. and Greenwich Capital Financial Products, Inc.
- 10.33(5) Stockholder Protection Rights Agreement
 - 10.33.1(8) Amendment to Stockholder Protection Rights Agreement effective as of September 26, 2001, by and among Registrant, State Street Bank and Trust Company and EquiServe Trust Company, N.A.
 - 10.33.2(8) Second Amendment to Stockholder Protection Rights Agreement dated as of June 10, 2002 by and between Registrant and EquiServe Trust Company, N.A.
- 10.34(6) Asset Purchase Agreement, dated as of January 19, 2001 by and among HanoverTrade.com, Inc., Registrant, Pamex Capital Partners, L.L.C. and the members of Pamex Capital Partners, L.L.C.
- 10.35 Amended and Restated Limited Liability Agreement as of November 21, 2002 by and among BTM 2001 HDMF-1 Corp., Hanover Capital Mortgage Holdings, Inc. and Provident Financial Group, Inc.
- 21 Subsidiaries of Hanover Capital Mortgage Holdings, Inc.
- 23.1 Independent Auditors' Consent
- 99.1 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 99.2 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

- (1) Incorporated herein by reference to Registrant's Registration Statement on Form S-11, Registration No. 333-29261, as amended, which became effective under the Securities Act of 1933, as amended, on September 15, 1997.
 - (2) Incorporated herein by reference to Registrant's Form 10-K for the year ended December 31, 1997, as filed with the Securities and Exchange Commission on March 31, 1998.
 - (3) Incorporated herein by reference to Registrant's Form 10-K for the year ended December 31, 1999, as filed with the Securities and Exchange Commission on March 30, 2000.
 - (4) Incorporated herein by reference to Registrant's Form 10-Q for the quarter ended March 31, 2000, as filed with the Securities and Exchange Commission on May 15, 2000.
 - (5) Incorporated herein by reference to Registrant's report on Form 8-K filed with the Securities and Exchange Commission on April 24, 2000.
 - (6) Incorporated herein by reference to Registrant's form 10-K for the year ended December 31, 2000, as filed with the Securities and Exchanges Commission on April 2, 2001.
 - (7) Incorporated herein by reference to Registrant's Form 10-Q for the quarter ended June 30, 2001, as filed with the Securities and Exchange Commission on August 14, 2001.
 - (8) Incorporated herein by reference to Registrant's Form 8-K filed with the Securities and Exchange Commission on July 16, 2002.
 - (9) Incorporated herein by reference to Registrant's Form 10-Q for the quarter ended June 30, 2002, as filed with the Securities and Exchange Commission on August 14, 2002.
- * Management contract or compensatory plan or arrangement required to be filed as an exhibit pursuant to Item 601 of Regulation S-K.

TABLE OF CONTENTS TO FINANCIAL STATEMENTS

	PAGE

HANOVER CAPITAL MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES	
Independent Auditors' Report	F-2
Consolidated Financial Statements as of December 31, 2002 and 2001 and for the Years Ended December 31, 2002, 2001 and 2000:	
Balance Sheets	F-3
Statements of Income	F-4
Statements of Stockholders' Equity	F-5
Statements of Cash Flows	F-6
Notes to Consolidated Financial Statements	F-7
HANOVER CAPITAL PARTNERS LTD. AND SUBSIDIARIES	
Independent Auditors' Report	F-36
Consolidated Financial Statements as of December 31, 2002 and 2001 and for the Years Ended December 31, 2002, 2001 and 2000:	
Balance Sheets	F-37
Statements of Income	F-38
Statements of Stockholder's Equity	F-39
Statements of Cash Flows	F-40
Notes to Consolidated Financial Statements	F-41
HANOVERTRADE, INC. AND SUBSIDIARY	
Independent Auditors' Report	F-46
Consolidated Financial Statements as of December 31, 2002 and 2001 and for the Years Ended December 31, 2002, 2001 and 2000:	
Balance Sheets	F-47
Statements of Operations	F-48
Statements of Stockholder's Equity	F-49
Statements of Cash Flows	F-50
Notes to Consolidated Financial Statements	F-51

INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Hanover Capital Mortgage Holdings, Inc. and Subsidiaries
Edison, New Jersey

We have audited the accompanying consolidated balance sheets of Hanover Capital Mortgage Holdings, Inc. and Subsidiaries (the "Company") as of December 31, 2002 and 2001, and the related consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2002. 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 auditing standards generally accepted in the United States of America. 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, such consolidated financial statements present fairly, in all material respects, the financial position of Hanover Capital Mortgage Holdings, Inc. and Subsidiaries as of December 31, 2002 and 2001, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America.

DELOITTE & TOUCHE LLP
Parsippany, New Jersey
March 20, 2003

HANOVER CAPITAL MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)

	DECEMBER 31,	
ASSETS	2002	2001
Mortgage loans:		
Held for sale	\$ 413	\$ 2,391
Collateral for CMOs	102,751	151,882
Mortgage securities pledged as collateral for reverse repurchase agreements:		
Available for sale	4,082	4,404
Held to maturity	559	768
Trading	2,669	33,182
Mortgage securities pledged as collateral for CMOs	9,805	9,840
Mortgage securities, not pledged:		
Available for sale	6,186	1,162
Trading	602	1,827
Cash and cash equivalents	10,605	8,946
Accounts receivable	2,450	777
Accrued interest receivable	960	1,960
Equity investments:		
Hanover Capital Partners Ltd.	--	1,808
HanoverTrade, Inc.	--	(4,789)
HDMF-I LLC	4,638	80
Notes receivable from related parties	2,563	12,538
Other assets	7,588	2,731
	-----	-----
TOTAL ASSETS	\$ 155,871	\$ 229,507
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES:		
Reverse repurchase agreements	\$ 6,283	\$ 33,338
CMO borrowing	102,589	151,096
Dividends payable	1,119	855
Accounts payable, accrued expenses and other liabilities	2,816	2,677
	-----	-----
TOTAL LIABILITIES	112,807	187,966
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY:		
Preferred stock, par value \$.01, 10 million shares authorized, -0- shares issued and outstanding		
Common stock, par value \$.01, 90 million shares authorized, 4,474,222 and 4,275,676 shares issued and outstanding at December 31, 2002 and 2001, respectively	45	43
Additional paid-in capital	67,990	67,082
Retained earnings (deficit)	(25,322)	(25,978)
Accumulated other comprehensive income	351	394
	-----	-----
TOTAL STOCKHOLDERS' EQUITY	43,064	41,541
	-----	-----
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 155,871	\$ 229,507
	=====	=====

See notes to consolidated financial statements

HANOVER CAPITAL MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(in thousands, except per share data)

	YEARS ENDED DECEMBER 31,		
	2002	2001	2000
REVENUES:			
Interest income	\$ 13,530	\$ 19,702	\$ 26,692
Interest expense	7,438	13,433	20,029
Net interest income	6,092	6,269	6,663
Loan loss provision	393	709	875
Net interest income after loan loss provision	5,699	5,560	5,788
Gain on sale of mortgage assets	2,095	3,782	819
Gain on mark to market of mortgage assets, net of associated hedge	1,367	751	431
Loan brokering, trading and advisory services	2,686	--	--
Due diligence fees	2,891	--	--
Assignment fees	1,387	--	--
Other income (loss)	(370)	(28)	--
Total revenue	15,755	10,065	7,038
EXPENSES:			
Personnel	5,479	680	1,020
Subcontractor	1,812	--	--
General and administrative	1,089	1,132	924
Legal and professional	1,070	1,247	555
Depreciation and amortization	655	24	21
Other	409	410	409
Occupancy	349	151	160
Travel and entertainment	317	48	45
Technology	293	4	2
Total expenses	11,473	3,696	3,136
Operating income	4,282	6,369	3,902
Equity in income (loss) of unconsolidated subsidiaries:			
Hanover Capital Partners Ltd.	112	43	455
HanoverTrade, Inc.	655	(3,263)	(1,495)
HDMF-I LLC	157	(35)	--
Hanover Capital Partners 2, Inc.	(19)	--	--
Income before income tax provision and cumulative effect of adoption of SFAS 133	5,187	3,114	2,862
Income tax provision	49	--	--
Income before cumulative effect of adoption of SFAS 133	5,138	3,114	2,862
Cumulative effect of adoption of SFAS 133	--	46	--
NET INCOME	\$ 5,138	\$ 3,160	\$ 2,862
BASIC EARNINGS PER SHARE:			
Before cumulative effect of adoption of SFAS 133	\$ 1.16	\$ 0.73	\$ 0.56
Cumulative effect of adoption of SFAS 133	--	0.01	--
After cumulative effect of adoption of SFAS 133	\$ 1.16	\$ 0.74	\$ 0.56
DILUTED EARNINGS PER SHARE:			
Before cumulative effect of adoption of SFAS 133	\$ 1.15	\$ 0.72	\$ 0.56
Cumulative effect of adoption of SFAS 133	--	0.01	--
After cumulative effect of adoption of SFAS 133	\$ 1.15	\$ 0.73	\$ 0.56

See notes to consolidated financial statements

HANOVER CAPITAL MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
YEARS ENDED DECEMBER 31, 2002, 2001 AND 2000
(in thousands, except share data)

	COMMON SHARES	STOCK AMOUNT	ADDITIONAL PAID-IN CAPITAL	COMPREHENSIVE INCOME	RETAINED EARNINGS (DEFICIT)	ACCUMULATED OTHER COMPREHENSIVE INCOME	TOTAL
	-----	-----	-----	-----	-----	-----	-----
BALANCE, DECEMBER 31, 1999	5,826,899	\$ 58	\$ 75,840		\$(25,496)	\$ 104	\$ 50,506
Repurchase of common stock	(1,503,955)	(15)	(7,294)				(7,309)
Comprehensive income:							
Net income				\$2,862	2,862		2,862
Other comprehensive income:							
Change in net unrealized gain (loss) on securities available for sale				1,216		1,216	1,216
Equity in other comprehensive loss of unconsolidated subsidiary				(148)		(148)	(148)
Comprehensive income				\$3,930			=====
Dividends declared					(3,103)		(3,103)
BALANCE, DECEMBER 31, 2000	4,322,944	43	68,546		(25,737)	1,172	44,024
Repurchase of common stock	(246,900)	(2)	(1,733)				(1,735)
Exercise of options	62,898	1	270				271
Exercise of warrants	136,734	1	(1)				--
Comprehensive income:							
Net income				\$3,160	3,160		3,160
Other comprehensive income:							
Change in net unrealized gain (loss) on securities available for sale				(561)		(561)	(561)
Change in net unrealized gain (loss) on interest rate caps designated as hedges				235		235	235
Unrealized cumulative effect of adoption of SFAS 133				(452)		(452)	(452)
Comprehensive income				\$2,382			=====
Dividends declared					(3,401)		(3,401)
BALANCE, DECEMBER 31, 2001	4,275,676	43	67,082		(25,978)	394	41,541
Repurchase of common stock	(50,641)	(1)	(373)				(374)
Capital contributed to related party	63,577	1	469				470
Exercise of options	185,610	2	812				814
Comprehensive income:							
Net income				\$5,138	5,138		5,138
Other comprehensive income:							
Change in net unrealized gain (loss) on securities available for sale				(207)		(207)	(207)
Change in net unrealized gain (loss) on interest rate caps designated as hedges				164		164	164
Comprehensive income				\$5,095			=====
Dividends declared					(4,482)		(4,482)
BALANCE, DECEMBER 31, 2002	4,474,222	\$ 45	\$ 67,990		\$(25,322)	\$ 351	\$ 43,064
	=====	=====	=====		=====	=====	=====

See notes to consolidated financial statements

HANOVER CAPITAL MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	YEARS ENDED DECEMBER 31,		
	2002	2001	2000
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	\$ 5,138	\$ 3,160	\$ 2,862
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation and amortization	655	24	21
Amortization of net premium and deferred costs	133	363	203
Loan loss provision	393	709	875
Gain on sale of mortgage assets	(2,095)	(3,782)	(873)
Gain on mark to market of mortgage assets	(1,367)	(1,058)	(816)
Gain on mark to market of mortgage assets for SFAS 133	--	(50)	--
Gain on disposition of real estate owned	(107)	--	--
Purchase of trading securities	(41,287)	(142,540)	(7,634)
Sale of trading securities	65,497	113,945	2,709
Distributions from unconsolidated subsidiaries in excess of equity (income) loss	552	3,255	1,041
(Increase) decrease in accounts receivable	(494)	134	(761)
Decrease in accrued interest receivable	1,072	506	460
(Increase) decrease in notes receivable from related parties	(1,342)	(4,651)	300
Decrease (increase) in other assets	104	250	(1,344)
(Decrease) increase in accounts payable, accrued expenses and other liabilities	(1,858)	91	(949)
Net cash provided by (used in) operating activities	24,994	(29,644)	(3,906)
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of mortgage loans	(51)	(2,172)	--
Purchase of mortgage securities	(4,866)	(4,431)	(2,934)
Purchase of mortgage securities from affiliate	--	--	(13,845)
Principal payments received on mortgage securities	4,446	5,067	8,001
Principal payments received on collateral for CMOs	48,837	59,701	57,254
Principal payments received on mortgage loans held for sale	209	11	21
Proceeds from sale of mortgage assets	10,197	16,076	43,054
Proceeds from disposition of real estate owned	253	--	--
Sales of mortgage securities to affiliates	945	--	--
Increase in cash due to acquisition of subsidiaries' residual interests	1,671	--	--
Capital contributions to HDMF-I LLC	(5,859)	(115)	--
Net cash provided by investing activities	55,782	74,137	91,551
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net (repayment of) borrowings from reverse repurchase agreements	(27,055)	18,578	(40,962)
Net repayment of CMOs	(48,526)	(59,207)	(45,685)
Increase in CMO discount	--	--	1,069
Payment of dividends	(4,218)	(3,411)	(2,822)
Repurchase of common stock	(132)	(1,736)	(7,309)
Exercise of stock options	814	271	--
Net cash used in financing activities	(79,117)	(45,505)	(95,709)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	1,659	(1,012)	(8,064)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	8,946	9,958	18,022
CASH AND CASH EQUIVALENTS, END OF YEAR	\$ 10,605	\$ 8,946	\$ 9,958

See notes to consolidated financial statements

HANOVER CAPITAL MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2002, 2001 AND 2000

1. ORGANIZATION AND BASIS OF PRESENTATION

Hanover Capital Mortgage Holdings, Inc. ("Hanover") was incorporated in Maryland on June 10, 1997. Hanover is a real estate investment trust ("REIT"), formed to operate as a specialty finance company. Hanover has two primary subsidiaries: Hanover Capital Partners Ltd. ("HCP") and HanoverTrade, Inc. ("HT"). When we refer to the "Company," we mean Hanover together with its consolidated and unconsolidated subsidiaries.

Pursuant to a Stock Purchase Agreement effective July 1, 2002 and approved by a special committee of disinterested members of its Board of Directors, Hanover acquired 100% of the outstanding common stock of each of HT, HCP and Hanover Capital Partners 2, Inc. ("HCP-2"), a previously inactive subsidiary. Hanover had previously owned 100% of the non-voting preferred stock, but none of the voting common stock, of each of HT, HCP and HCP-2. This ownership structure was established in order to satisfy tax laws governing Hanover's status as a REIT. Changes in the tax laws made it possible for Hanover to acquire voting control of HT, HCP and HCP-2 and operate under new rules permitting REITs to wholly own subsidiaries such as HT, HCP and HCP-2. Therefore, as of July 1, 2002, Hanover owns 100% of the outstanding capital stock of each of HT, HCP and HCP-2, and for periods ending after June 30, 2002, Hanover's financial statements will be consolidated with the financial statements of HT, HCP and HCP-2.

Hanover acquired the common shares of HT, HCP and HCP-2 from four of its directors who are also executive officers. An independent appraiser determined that the value of the common shares of HT and HCP was \$474,000 in the aggregate. The parties agreed that the common shares of HCP-2 would be transferred to Hanover as part of this transaction for no additional consideration. Each of the four selling executives agreed that the purchase price would be used to partially repay certain indebtedness owing to Hanover from them. Each of these four executives also received a bonus in an amount sufficient to cover the tax liability they incurred in connection with this transaction.

The Company is engaged in three principal businesses, which are conducted through its three primary operating units: Hanover, HCP and HT. The principal business strategy of Hanover is to invest in mortgage-backed securities ("MBS") and mortgage loans for its own account, and, commencing in 2001, for third parties. The principal business strategy of HCP is to generate consulting and other fee income by providing consulting and due diligence services, focusing on loan sale advisory, loan file due diligence reviews, staffing solutions and mortgage assignment and collateral rectification services. The principal business activity of HT is to generate fee income by operating an Internet exchange for trading mortgage loans, mortgage servicing rights and related assets, and providing state-of-the-art technologies supported by experienced valuation, operations and trading professionals. Hanover also maintains an equity investment in HDMF-I LLC ("HDMF-I"). HDMF-I was organized in August 2001 to purchase, service, manage and ultimately re-sell or otherwise liquidate pools of primarily sub- and non-performing one-to-four family residential mortgage loans.

The Company's principal business objective is to generate net interest income on its portfolio of mortgage securities and mortgage loans and to generate fee income through HCP, HT and third party asset-management contracts.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

PRINCIPLES OF CONSOLIDATION - The consolidated financial statements include the accounts of Hanover Capital Mortgage Holdings, Inc. and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated.

BASIS OF PRESENTATION - The consolidated financial statements of the Company are prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America ("GAAP") and in conformity with the rules and regulations of the Securities and Exchange Commission ("SEC"). In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included.

USE OF ESTIMATES; RISKS AND UNCERTAINTIES - The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates, by their nature, are based on judgment and available information. Actual results could differ from the estimates. The Company's estimates and assumptions primarily arise from risks and uncertainties associated with interest rate volatility, credit exposure and regulatory changes. Although management is not currently aware of any factors that would significantly change its estimates and assumptions in the near term, future changes in market trends and conditions may occur which could cause actual results to differ materially.

CASH AND CASH EQUIVALENTS - Cash and cash equivalents include cash on hand, overnight investments deposited with banks and money market mutual funds primarily invested in government securities with weighted maturities less than 60 days.

MORTGAGE LOANS - The Company's policy is to classify each of its mortgage loans as held for sale as they are purchased and each asset is monitored for a period of time, generally four to nine months, prior to making a determination as to whether the asset will be classified as held to maturity. Mortgage loans that are securitized in a collateralized mortgage obligation ("CMO") are classified as collateral for CMOs as of the closing date of the CMO. All mortgage loans designated as held for sale are reported at the lower of cost or market, with unrealized losses reported as a charge to earnings in the current period. Mortgage loans designated as held to maturity and CMO collateral are reported at the lower of the original cost of the mortgage loans or the market value of the mortgage loans as of the date they were designated as CMO collateral or held to maturity.

Premiums, discounts and certain deferred costs associated with the purchase of mortgage loans are amortized into interest income over the lives of the mortgage loans using the effective yield method adjusted for the effects of estimated prepayments. Mortgage loan transactions are recorded on the date the mortgage loans are purchased or sold. Purchases of new mortgage loans are recorded when all significant uncertainties regarding the characteristics of the mortgage loans are removed, generally on or shortly before settlement date. Realized gains and losses on mortgage loan transactions are determined on the specific identification basis.

The accrual of interest on impaired loans is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due. When an interest accrual is discontinued, all associated unpaid accrued interest income is reversed. Interest income is subsequently recognized only to the extent cash payments are received.

The Company seeks to limit its exposure to credit losses on its portfolio of mortgage loans by performing an in-depth due diligence review on every loan purchased. The due diligence review encompasses the borrower's credit, the enforceability of the documents, and the value of the mortgaged property. In addition, many mortgage loans are guaranteed by an agency of the federal government or private mortgage insurance. The Company monitors the delinquencies and losses on the underlying mortgages and makes a provision for

known losses as well as unidentified potential losses in its mortgage loan portfolio if the impairment is deemed to be other than temporary. The provision is based on management's assessment of numerous factors affecting its portfolio of mortgage loans including, but not limited to, current and projected economic conditions, delinquency status, losses to date on mortgages and remaining credit protection.

MORTGAGE SECURITIES - The Company's policy is to generally classify mortgage securities as available for sale as they are acquired. Each available for sale mortgage security is monitored for a period of time prior to making a determination whether the asset will be classified as held to maturity or trading. Management reevaluates the classification of the mortgage securities on a quarterly basis.

Mortgage securities designated as available for sale are reported at fair value, with unrealized gains and losses excluded from earnings and reported as a separate component of stockholders' equity.

Mortgage securities designated as trading are reported at fair value. Gains and losses resulting from changes in fair value are recorded as income or expense and included in earnings.

Mortgage securities classified as held to maturity are carried at amortized cost unless a decline in value is deemed other than temporary, in which case the carrying value is reduced. The amortization of premiums or accretion of discounts and any unrealized losses deemed other than temporary are included in current period earnings.

Mortgage securities transactions are recorded on settlement date for mortgage securities purchased or sold. Purchases of new issue mortgage securities are recorded when all significant uncertainties regarding the characteristics of the mortgage securities are removed, generally on settlement date. Realized gains and losses on mortgage securities transactions are determined on the specific identification basis.

The Company purchases both investment-grade and below-investment-grade MBS. Below-investment-grade MBS have the potential to absorb credit losses caused by delinquencies and defaults on the underlying mortgage loans. When purchasing below-investment-grade MBS, the Company leverages HCP's due diligence operations and management's substantial mortgage credit expertise to make a thorough evaluation of the underlying mortgage loan collateral. The Company monitors the delinquencies and the defaults on the underlying mortgages of its mortgage securities and, if an impairment is deemed to be other than temporary, reduces the carrying value to fair value. The Company's loan loss provision, utilized in establishing its loan loss allowance, is based on management's assessment of numerous factors affecting its portfolio of mortgage securities including, but not limited to, current and projected economic conditions, delinquency status, credit losses to date on underlying mortgages and remaining credit protection. The adjustment of the carrying value is made by reducing the cost basis of the individual security and the amount of such write-down is recorded directly against the loan loss allowance. Provisions for credit losses do not reduce taxable income and therefore do not affect the dividends paid by the Company to stockholders in the period the provisions are taken. Actual losses realized by the Company reduce taxable income in the period the actual loss is realized and may affect the dividends paid to stockholders for that tax year.

EQUITY INVESTMENTS - Hanover records its investment in HDMF-I on the equity method. Accordingly, Hanover records its proportionate share of the earnings or losses of HDMF-I. For all periods prior to July 1, 2002, Hanover recorded 97% of the earnings or losses of HCP and HT and 99% of the earnings or losses of HCP-2 based on the equity method. Effective July 1, 2002, Hanover's financial statements are consolidated with the financial statements of HT, HCP and HCP-2.

REVERSE REPURCHASE AGREEMENTS - Reverse repurchase agreements are accounted for as collateralized financing transactions and recorded at their contractual amounts, plus accrued interest.

FINANCIAL INSTRUMENTS - The Company, from time to time, enters into interest rate hedge mechanisms (forward sales of mortgage securities issued by U.S. government agencies) to manage its exposure to changes in interest rates in connection with the purchase, holding, securitization and sale of its mortgage securities and mortgage loan portfolio. The Company generally closes out the hedge position to coincide with a long-term securitization

financing transaction or with any sale. As such hedges are considered freestanding derivatives for accounting purposes, the Company recognizes changes in the fair value of such hedges in earnings in the period of change.

The Company also enters into interest rate caps to manage its interest rate exposure on certain reverse repurchase agreements and collateralized mortgage obligation, or CMO, financing. For interest rate caps designated as cash flow hedges for accounting purposes, the effective portion of the gain or loss due to changes in fair value is reported in other comprehensive income, and the ineffective portion is reported in earnings in the period of change. For interest rate caps designated as freestanding derivatives for accounting purposes, changes in fair value are recognized in earnings in the period of change. Any payment received under the interest rate cap agreements is recorded as a reduction of interest expense on the reverse repurchase agreement financing.

For derivative financial instruments designated as hedge instruments for accounting purposes, the Company periodically evaluates the effectiveness of these hedges against the financial instrument being hedged. The Company considers a hedge to be effective so long as there is adequate correlation between the hedged results and the change in fair value of the hedged financial instrument. If the hedge instrument performance does not result in adequate correlation between the changes in fair value of the hedge instrument and the related hedged financial instrument, the Company will terminate the hedge for accounting purposes and mark the carrying value of the hedge instrument to market in earnings in the period of change. If a hedge instrument is sold or matures, or the criteria that were anticipated at the time the hedge instrument was entered into no longer exist, the hedge instrument is no longer designated as a hedge for accounting purposes. Under these circumstances, the accumulated change in the market value of the hedge is recognized in current period income or loss to the extent that the effects of interest rate or price changes of the hedged item have not offset the hedged results.

The Company has provided fair value estimates and information about valuation methodologies. The estimated fair value amounts have been determined using available market information or appropriate valuation methodologies. However, considerable judgment is required in interpreting market data to develop estimates of fair value, so the estimates are not necessarily indicative of the amounts that would be realized in a current market exchange. The effect of using different market assumptions and/or estimation methodologies may materially impact the estimated fair value amounts.

REVENUE RECOGNITION - Revenues from loan brokering, trading and advisory services are recognized when the transactions close and fees are earned and billed. At the time of closing a transaction, the number of loans, loan principal balance and purchase price in the transaction are agreed upon, documentation is signed and the sale is funded. The Company's billing of fees relating to a transaction occurs concurrently with the closing and funding. Revenues from due diligence contracts in progress and assignment preparation services are recognized for the services provided as they are earned and billed.

INCOME TAXES - Hanover has elected to be taxed as a REIT and intends to comply with the provisions of the Internal Revenue Code of 1986, as amended (the "Code") with respect thereto. Accordingly, Hanover will not be subject to Federal or state income tax on that portion of its income that is distributed to stockholders, as long as certain asset, income and stock ownership tests are met.

HCP and HT file separate consolidated Federal income tax returns. HCP and HT use the asset and liability method in accounting for income taxes. Deferred income taxes are provided for the effect of temporary differences between the tax basis and financial statement carrying amounts of assets and liabilities.

EARNINGS PER SHARE - Basic earnings or loss per share excludes dilution and is computed by dividing income or loss available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted earnings or loss per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock that then shared in earnings and losses. Shares issued during the period and shares reacquired during the period are weighted for the period they were outstanding.

COMPREHENSIVE INCOME - Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities and interest rate caps designated as hedges, are reported as separate components of the equity section of the Consolidated Balance Sheets, such items, along with net income, are components of comprehensive income.

RECLASSIFICATION - Certain reclassifications of prior years' amounts have been made to conform to the current year presentation.

RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS - On January 1, 2002, the Company adopted Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets ("SFAS 144"). SFAS 144 supersedes Statement No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of ("SFAS 121"). SFAS 144 retains the requirements of SFAS 121 for recognizing and measuring the impairment loss of long-lived assets to be held and used. For long-lived assets to be disposed of by sale, SFAS 144 requires a single accounting model be used for all long-lived assets, whether previously held and used or newly acquired. The adoption of SFAS 144 did not have an impact on the Company's consolidated financial position or results of operations.

In April 2002, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 145, Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections ("SFAS 145"). SFAS 145 rescinds FASB Statement No. 4, Reporting Gains and Losses from Extinguishment of Debt, and an amendment of that Statement, FASB Statement No. 64, Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements. SFAS 145 also rescinds FASB Statement No. 44, Accounting for Intangible Assets of Motor Carriers. SFAS 145 amends FASB Statement No. 13, Accounting for Leases, to eliminate an inconsistency between the required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. The provisions of SFAS 145 related to the rescission of FASB Statement No. 4 are generally effective for fiscal years beginning after May 15, 2002. The adoption of SFAS 145 did not have a material effect on the Company's consolidated financial statements.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS - In July 2002, the FASB issued Statement of Financial Accounting Standards No. 146, Accounting for Costs Associated with Exit or Disposal Activities ("SFAS 146"). SFAS 146 requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. SFAS 146 is to be applied prospectively to exit or disposal activities initiated after December 31, 2002. The adoption of SFAS 146 will not have a material effect on our consolidated financial statements.

On November 25, 2002, the FASB issued FASB Interpretation No. ("FIN") 45 ("FIN 45"), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, an interpretation of FASB Statements No. 5, 57 and 107 and Rescission of FASB Interpretation No. 34." FIN 45 clarifies the requirements of FASB Statement No. 5, "Accounting for Contingencies," relating to the guarantor's accounting for, and disclosure of, the issuance of certain types of guarantees. The disclosure requirements of FIN 45 are effective for financial statements of interim or annual periods that end after December 15, 2002. The disclosure provisions have been implemented and no disclosures were required at year-end 2002. The provisions for initial recognition and measurement are effective on a prospective basis for guarantees that are issued or modified after December 31, 2002, irrespective of the guarantor's year-end. FIN 45 requires that upon issuance of a guarantee, the entity must recognize a liability for the fair value of the obligation it assumes under that guarantee. The Company's adoption of FIN 45 in 2003 has not and is not expected to have a material effect on the Company's consolidated financial statements.

In January 2003, the FASB issued FIN 46, "Consolidation of Variable Interest Entities - an interpretation of ARB No. 51," which addresses consolidation of variable interest entities. FIN 46 expands the criteria for consideration in determining whether a variable interest entity should be consolidated by a business entity, and requires existing unconsolidated variable interest entities (which include, but are not limited to, Special Purpose Entities, or SPEs) to be consolidated by their primary beneficiaries if the entities do not effectively disperse risks among parties involved. This interpretation applies immediately to variable interest entities created after January 31, 2003, and to variable interest entities in which an enterprise obtains an interest after that date. It applies in the first fiscal year or interim period beginning after June 15, 2003, to variable interest entities in which an enterprise holds a variable interest that it acquired before February 1, 2003. The adoption of FIN 46 is not expected to have a material effect on the Company's consolidated financial statements.

3. MORTGAGE LOANS

MORTGAGE LOANS HELD FOR SALE
(dollars in thousands)

	DECEMBER 31, 2002			DECEMBER 31, 2001		
	FIXED RATE	ADJUSTABLE RATE	TOTAL	FIXED RATE	ADJUSTABLE RATE	TOTAL
Principal amount of mortgage loans	\$ 48	\$ 499	\$ 547	\$ 560	\$ 2,627	\$ 3,187
Net premium (discount) and deferred costs	(3)	(111)	(114)	(159)	(637)	(796)
Loan loss allowance	--	(20)	(20)	--	--	--
Carrying value of mortgage loans	\$ 45	\$ 368	\$ 413	\$ 401	\$ 1,990	\$ 2,391

MORTGAGE LOANS SECURITIZED IN COLLATERALIZED MORTGAGE OBLIGATIONS
(dollars in thousands)

	DECEMBER 31, 2002			DECEMBER 31, 2001		
	FIXED RATE	ADJUSTABLE RATE	TOTAL	FIXED RATE	ADJUSTABLE RATE	TOTAL
Principal amount of mortgage loans	\$ 71,127	\$ 31,365	\$ 102,492	\$ 105,849	\$ 45,535	\$ 151,384
Net premium (discount) and deferred costs	982	(152)	830	1,442	(167)	1,275
Loan loss allowance	(377)	(194)	(571)	(553)	(224)	(777)
Carrying value of mortgage loans	\$ 71,732	\$ 31,019	\$ 102,751	\$ 106,738	\$ 45,144	\$ 151,882

Hanover's securitizations were issued with various call provisions, generally allowing for the termination of the securitization at the earlier of a certain date or when the outstanding collateral balance is less than a pre-established percentage of the original collateral balance. During December 2002, Hanover exercised the call provisions of its 1998-A securitization. As of December 31, 2002, Group 3 of Hanover's 1998-B securitization was callable. As discussed in Note 19 to the Consolidated Financial Statements, the mortgage loans underlying the CMOs were sold during the first quarter of 2003.

4. MORTGAGE SECURITIES

FIXED-RATE AGENCY MORTGAGE-BACKED SECURITIES
(dollars in thousands)

	DECEMBER 31, 2001			
	AVAILABLE FOR SALE	HELD TO MATURITY	TRADING	TOTAL
Principal balance of mortgage securities	\$1,378	\$ --	\$25,251	\$26,629
Net premium(discount) and deferred costs	70	--	2,258	2,328
Total amortized cost of mortgage securities	1,448	--	27,509	28,957
Net unrealized gain (loss)	62	--	45	107
Carrying value of mortgage securities	\$1,510	\$ --	\$27,554	\$29,064

At December 31, 2002, there were no fixed-rate agency mortgage-backed securities.

FIXED-RATE SUBORDINATE MORTGAGE-BACKED SECURITIES
(dollars in thousands)

	DECEMBER 31, 2002				
	AVAILABLE FOR SALE	HELD TO MATURITY	TRADING	COLLATERAL FOR CMOS	TOTAL
Principal balance of mortgage securities	\$ 17,472	\$ --	\$ 3,433	\$ 12,636	\$ 33,541
Net premium (discount) and deferred costs	(9,164)	--	(510)	(2,466)	(12,140)
Total amortized cost of mortgage securities	8,308	--	2,923	10,170	21,401
Loan loss allowance	(182)	--	--	(365)	(547)
Net unrealized gain (loss)	434	--	348	--	782
Carrying value of mortgage securities	\$ 8,560	\$ --	\$ 3,271	\$ 9,805	\$ 21,636

	DECEMBER 31, 2001				
	AVAILABLE FOR SALE	HELD TO MATURITY	TRADING	COLLATERAL FOR CMOS	TOTAL
Principal balance of mortgage securities	\$ 6,561	\$ --	\$ 6,433	\$ 12,926	\$ 25,920
Net premium (discount) and deferred costs	(3,440)	--	(2,452)	(2,742)	(8,634)
Total amortized cost of mortgage securities	3,121	--	3,981	10,184	17,286
Loan loss allowance	(221)	--	--	(344)	(565)
Net unrealized gain (loss)	623	--	792	--	1,415
Carrying value of mortgage securities	\$ 3,523	\$ --	\$ 4,773	\$ 9,840	\$ 18,136

ADJUSTABLE-RATE SUBORDINATE MORTGAGE-BACKED SECURITIES
(dollars in thousands)

	DECEMBER 31, 2002				
	AVAILABLE FOR SALE	HELD TO MATURITY	TRADING	COLLATERAL FOR CMOS	TOTAL
Principal balance of mortgage securities	\$ 2,121	\$ --	\$ --	\$ --	\$ 2,121
Net premium (discount) and deferred costs	(963)	--	--	--	(963)
Total amortized cost of					

mortgage securities	1,158	--	--	--	1,158
Loan loss allowance	(25)	--	--	--	(25)
Net unrealized gain (loss)	2	--	--	--	2
	-----	-----	-----	-----	-----
Carrying value of mortgage securities	\$ 1,135	\$ --	\$ --	\$ --	\$ 1,135
	=====	=====	=====	=====	=====

DECEMBER 31, 2001

	AVAILABLE FOR SALE	HELD TO MATURITY	TRADING	COLLATERAL FOR CMOS	TOTAL
	-----	-----	-----	-----	-----
Principal balance of mortgage securities	\$ --	\$ --	\$ 3,692	\$ --	\$ 3,692
Net premium (discount) and deferred costs	--	--	(997)	--	(997)
	-----	-----	-----	-----	-----
Total amortized cost of mortgage securities	--	--	2,695	--	2,695
Loan loss allowance	--	--	--	--	--
Net unrealized gain (loss)	--	--	(13)	--	(13)
	-----	-----	-----	-----	-----
Carrying value of mortgage securities	\$ --	\$ --	\$ 2,682	\$ --	\$ 2,682
	=====	=====	=====	=====	=====

DERIVATIVE MORTGAGE-BACKED SECURITIES
(dollars in thousands)

DECEMBER 31, 2002

	INTEREST- ONLY STRIPS AVAILABLE FOR SALE	PRINCIPAL- ONLY STRIPS HELD TO MATURITY	TRADING	TOTAL
	-----	-----	-----	-----
Principal balance of mortgage securities	\$ --	\$ 681	\$ --	\$ 681
Net premium (discount) and deferred costs	339	(122)	--	217
	-----	-----	-----	-----
Total amortized cost of mortgage securities	339	559	--	898
Loan loss allowance	--	--	--	--
Net unrealized gain (loss)	234	--	--	234
	-----	-----	-----	-----
Carrying value of mortgage securities	\$ 573	\$ 559	\$ --	\$1,132
	=====	=====	=====	=====

DECEMBER 31, 2001

	INTEREST- ONLY STRIPS AVAILABLE FOR SALE	PRINCIPAL- ONLY STRIPS HELD TO MATURITY	TRADING	TOTAL
	-----	-----	-----	-----
Principal balance of mortgage securities	\$ --	\$ 929	\$ --	\$ 929
Net premium (discount) and deferred costs	639	(161)	--	478
	-----	-----	-----	-----
Total amortized cost of mortgage securities	639	768	--	1,407
Loan loss allowance	--	--	--	--
Net unrealized gain (loss)	(106)	--	--	(106)
	-----	-----	-----	-----
Carrying value of mortgage securities	\$ 533	\$ 768	\$ --	\$ 1,301
	=====	=====	=====	=====

The carrying values of the Company's mortgage securities by average life as of December 31, 2002 are as follows (dollars in thousands):

AVERAGE LIFE	AVAILABLE FOR SALE	HELD TO MATURITY	TRADING	COLLATERAL FOR CMOS
Less than five years	\$ 1,325	\$ 352	\$ --	\$9,785
Five to ten years	7,799	207	3,271	20
More than ten years	1,144	--	--	--
	<u>\$10,268</u>	<u>\$ 559</u>	<u>\$3,271</u>	<u>\$9,805</u>

Actual maturities may differ from stated maturities because borrowers usually have the right to prepay certain obligations, oftentimes without penalties. Maturities of mortgage securities depend on the repayment characteristics and experience of the underlying mortgage loans.

The proceeds and gross realized gain (loss) from sales of available for sale mortgage securities in 2002, 2001 and 2000 were as follows (dollars in thousands):

	YEAR ENDED DECEMBER 31, 2002		
	PROCEEDS	GROSS REALIZED GAIN	GROSS REALIZED LOSS
Sale of subordinate MBS	\$ 7,288	\$1,771	\$ (3)
Sale of Agency pass-through MBS	1,307	55	--

	YEAR ENDED DECEMBER 31, 2001		
	PROCEEDS	GROSS REALIZED GAIN	GROSS REALIZED LOSS
Sale of subordinate MBS	\$16,079	\$3,585	\$ (2)

	YEAR ENDED DECEMBER 31, 2000		
	PROCEEDS	GROSS REALIZED GAIN	GROSS REALIZED LOSS
Sale of subordinate MBS	\$ 5,882	\$1,248	\$ --
Sale of Agency pass-through MBS	39,881	--	(429)

5. CONCENTRATION OF CREDIT RISK

MORTGAGE LOANS - The Company's exposure to credit risk associated with its investment activities is measured on an individual customer basis as well as by groups of customers that share similar attributes. In the normal course of its business, the Company has concentrations of credit risk in its mortgage portfolio for the loans in certain geographic areas. At December 31, 2002, the percent of the total principal amount of loans outstanding in any one state exceeding 5% of the principal amount of mortgage loans are as follows:

MORTGAGE LOANS HELD AS COLLATERAL FOR CMOS	
Florida	15%
California	12
Texas	12
	--
Total	39%
	==

The Company did not have any material concentrations of credit risk in its held for sale category at December 31, 2002.

MORTGAGE SECURITIES - The Company's exposure to credit risk associated with its investment activities is measured on an individual security basis as well as by groups of securities that share similar attributes. In certain instances, the Company has concentrations of credit risk in its mortgage securities portfolio for the securities of certain issuers.

CONCENTRATION OF CREDIT RISK BY ISSUER
(dollars in thousands)

ISSUER	DECEMBER 31, 2002				
	AVAILABLE FOR SALE	HELD TO MATURITY	TRADING	COLLATERAL FOR CMOS	TOTAL
Hanover Capital 1998-B	\$ 573	\$ 559	\$ --	\$ 9,805	\$ 10,937
Issuer 1	4,060	--	372	--	4,432
Issuer 2	903	--	1,371	--	2,274
Issuer 3	2,150	--	--	--	2,150
Issuer 4	626	--	1,298	--	1,924
Issuer 5	669	--	--	--	669
Issuer 6	507	--	--	--	507
Issuer 7	507	--	--	--	507
Issuer 8	273	--	230	--	503
Total	\$ 10,268	\$ 559	\$ 3,271	\$ 9,805	\$ 23,903

CASH AND OVERNIGHT INVESTMENTS - The Company has cash and cash equivalents in major financial institutions which are insured by the Federal Deposit Insurance Corporation ("FDIC") up to \$100,000 per institution for each legal entity. At December 31, 2002, the Company had amounts on deposit with the financial institutions in excess of FDIC limits. At December 31, 2002, the Company had overnight investments of \$10,026,000 primarily in money market mutual funds invested in government securities. The Company limits its risk by placing its cash and cash equivalents in high quality financial institutions, Federal Agency notes or mutual funds of government securities.

6. LOAN LOSS ALLOWANCE

The following table summarizes the activity in the loan loss allowance (dollars in thousands):

	YEARS ENDED DECEMBER 31,		
	2002	2001	2000
Balance, beginning of period	\$ 1,342	\$ 1,724	\$ 799
Loan loss provision	393	709	875
Transfers from related company	--	--	729
Sales	(197)	(852)	(593)
Charge-offs	(395)	(241)	(92)
Recoveries	--	2	6
Balance, end of period	\$ 1,143	\$ 1,342	\$ 1,724

7. EQUITY INVESTMENTS

As of and for the six months ended June 30, 2002 and for the years ended December 31, 2001 and 2000, Hanover owned 100% of the non-voting preferred stock of HCP, HT and HCP-2. These ownership interests entitled Hanover to receive 97% of the earnings or losses of HCP and HT and 99% of the earnings or losses of HCP-2. As discussed in Note 1 to the Consolidated Financial Statements, effective July 1, 2002, Hanover acquired 100% of the common stock of HCP, HT and HCP-2; therefore, for the periods ending after June 30, 2002, the financial statements of HCP, HT and HCP-2 will be consolidated with the financial statements of Hanover.

The table below reflects the activity recorded in Hanover's equity investments (dollars in thousands):

	YEARS ENDED DECEMBER 31,								
	2002				2001				
	HCP	HT	HCP-2	HDMF-I	TOTAL	HCP	HT	HDMF-I	TOTAL
Beginning balance	\$ 1,808	\$(4,789)	\$ --	\$ 80	\$(2,901)	\$1,765	\$(1,526)	\$ --	\$ 239
Capital contribution	--	470	--	5,859	6,329	--	--	115	115
Applicable % of net income (loss)	112	655	(19)	157	905	43	(3,263)	(35)	(3,255)
Applicable % of comprehensive loss	--	--	--	--	--	--	--	--	--
Distributions	--	--	--	(1,458)	(1,458)	--	--	--	--
Impact of acquisition of subsidiaries' common stock	(1,920)	3,664	19	--	1,763	--	--	--	--
Ending balance	\$ --	\$ --	\$ --	\$ 4,638	\$ 4,638	\$1,808	\$(4,789)	\$ 80	\$(2,901)

	YEARS ENDED DECEMBER 31,		
	2000		
	HCP	HT	TOTAL
Beginning balance	\$ 1,466	\$ (30)	\$ 1,436
Capital contribution	--	--	--
Applicable % of net income (loss)	455	(1,496)	(1,041)
Applicable % of comprehensive loss	(156)	--	(156)
Distributions	--	--	--
Impact of acquisition of subsidiaries' common stock	--	--	--
Ending balance	\$ 1,765	\$(1,526)	\$ 239

8. NOTES RECEIVABLE AND DUE FROM RELATED PARTIES

As of December 31, 2002, Hanover had \$2,563,000 of loans outstanding to four executive officers ("Principals"), \$870,000 of loans outstanding to HCP and \$7,396,000 of loans outstanding to HT. The loans to HCP and HT are eliminated in the consolidated financial statements as of December 31, 2002. Subsequent to June 30, 2002, the interest income and related expense on the loans to HCP and HT are eliminated in the consolidated financial statements.

NOTES RECEIVABLE (dollars in thousands)

	DECEMBER 31, 2002	INTEREST RATE	MATURITY DATE
Principals	\$ 483	6.02%	September 2007
	1,267	5.70	September 2007
	813	5.51	March 2003
HCP	870	3.25	March 2004
HT	7,396	3.25	March 2004
Eliminations	(8,266)		
	\$ 2,563		

The loans to Principals are partially secured solely by 116,667 shares of Hanover's common stock owned by the Principals, collectively. The loans to HCP and HT are unsecured.

Additional amounts due from related parties at December 31, 2002 are as follows (dollars in thousands):

ACCRUED INTEREST RECEIVABLE	OTHER RECEIVABLES	TOTAL
-----------------------------------	----------------------	-------

HCP	\$ 5	\$ 15	\$ 20
HT	58	173	231
HDMF-I	--	101	101
Other	5	--	5
Eliminations	(63)	(188)	(251)
	-----	-----	-----
	\$ 5	\$ 101	\$ 106
	=====	=====	=====

9. REVERSE REPURCHASE AGREEMENTS

At December 31, 2002, the Company had outstanding borrowings on retained CMO securities of \$1,698,000 with a weighted average borrowing rate of 2.97% and a weighted average remaining maturity of one month. Retained CMO securities represent the Company's net investment in the CMOs issued by the Company. The reverse repurchase financing agreements at December 31, 2002 are collateralized by securities with a cost basis of \$9,922,000.

At December 31, 2002, the Company had outstanding reverse repurchase agreement financing for mortgage securities (other than retained CMO securities) of \$4,585,000 with a weighted average borrowing rate of 3.37% and a remaining maturity of less than one month. These mortgage securities are mortgage securities that the Company has purchased or created in transactions other than CMOs. The repurchase agreement financing at December 31, 2002 was collateralized by securities with a cost basis of \$7,310,000.

At December 31, 2002, the Company had available capacity to borrow \$10 million under a committed reverse repurchase line of credit. This committed line matures on March 27, 2003.

Information pertaining to reverse repurchase agreement financing as of and for the years ended December 31, 2002 and 2001 is summarized as follows (dollars in thousands):

REVERSE REPURCHASE AGREEMENT FINANCING

	YEARS ENDED DECEMBER 31,			
	2002		2001	
	RETAINED CMO SECURITIES	OTHER MORTGAGE SECURITIES	RETAINED CMO SECURITIES	OTHER MORTGAGE SECURITIES
REVERSE REPURCHASE AGREEMENTS				
Balance of borrowing at end of period	\$1,698	\$ 4,585	\$ 1,910	\$31,428
Average borrowing balance during the period	\$1,786	\$12,538	\$ 2,536	\$15,817
Average interest rate during the period	2.97%	3.37%	7.16%	6.58%
Maximum month-end borrowing balance during the period	\$1,889	\$28,899	\$ 3,626	\$33,496
COLLATERAL UNDERLYING THE AGREEMENTS				
Balance at end of period - carrying value	\$9,922	\$ 7,310	\$10,626	\$38,354

Additional information pertaining to individual reverse repurchase agreement lenders at December 31, 2002 is summarized as follows (dollars in thousands):

LENDER	TYPE OF COLLATERAL	REVERSE REPURCHASE FINANCING	UNDERLYING COLLATERAL	WEIGHTED AVERAGE MATURITY DATE
Lender A (committed)	Retained CMO Securities	\$ 1,698	\$ 9,922	March 27, 2003
Lender A	Mortgage Securities	578	1,133	January 8, 2003 (a)
Lender B	Mortgage Securities	2,354	3,689	January 6, 2003 (a)
Lender C	Mortgage Securities	1,028	1,390	January 10, 2003 (a)
Lender D	Mortgage Securities	625	1,098	January 16, 2003 (a)
Total		\$ 6,283	\$ 17,232	

(a) These borrowings are pursuant to uncommitted lines of credit which are typically renewed monthly.

10. CMO BORROWING, SECURITIZED SALE AND MANAGED MORTGAGED LOANS

The Company has executed five securitization transactions since April 1998. Four of these transactions were structured as financings, and one of these transactions ("Hanover 1998-B") was structured as a sale transaction. In the financing transactions, the Company pledged mortgage loans to secure CMOs. These mortgage loans are treated as assets of the Company and the CMOs are treated as debt of the Company. In contrast, the mortgage loans financed through the issuance of Hanover 1998-B were treated as having been sold, and the corresponding debt is not treated as debt of the Company.

COLLATERALIZED MORTGAGE OBLIGATIONS (CMOS) - Borrower remittances received on the CMO collateral are used to make payments on the CMOs. The obligations of the CMO are payable solely from the underlying mortgage loans collateralizing the debt and otherwise are non-recourse to the Company. The maturity of each class of CMO is directly affected by principal prepayments on the related CMO collateral. Each class of CMO is also subject to redemption according to specific terms of the respective indenture agreements. As a result, the actual maturity of any class of CMO is likely to occur earlier than its stated maturity.

Information pertaining to the CMOs as of and for the year ended December 31, 2002 is summarized as follows (dollars in thousands):

	SECURITIZATIONS				
	2000-A	1999-B	1999-A	1998-A	TOTAL
Balance of borrowing at end of period	\$10,737	\$32,208	\$43,000	\$16,644	\$102,589
Average borrowing balance during the period	10,821	39,858	51,612	22,681	124,972
Average interest rate during the period	10.12%	3.00%	6.07%	6.77%	5.57%
Interest rate at end of period	9.88%	3.09%	6.61%	6.98%	5.91%
Maximum month-end borrowing balance during the period	10,887	48,115	59,537	27,864	146,403
CMO collateral					
Balance at end of period - carrying value	\$ 9,557	\$35,667	\$48,504	\$18,580	\$112,308

During December 2002, Hanover exercised the call provisions of its 1998-A securitization. As of December 31, 2002, Group 3 of Hanover's 1998-B securitization was callable. As discussed in Note 19 to the Consolidated Financial Statements, the mortgage loans underlying the CMOs were sold during the first quarter of 2003.

Aggregate annual principal repayments of mortgage-backed bonds based upon the expected amortization of the underlying mortgage loan collateral at December 31, 2002 were as follows (dollars in thousands):

YEAR	AMOUNT
2003	\$ 27,284
2004	20,037
2005	14,872
2006	11,014
2007	8,135
Thereafter	21,150
	\$ 102,492

SECURITIZED SALE - At December 31, 2002, the Company had a remaining investment of \$10,937,000 in securities retained from Hanover 1998-B; these securities had a fair value of \$12,098,000. The Company determines the fair value of these securities by obtaining market quotes from a third party dealer firm. In providing these quotes, the dealer firm used the following assumptions for the Hanover 1998-B securities:

TYPE OF SECURITY	CREDIT RATING	SPREAD	DISCOUNT RATE	PREPAYMENT SPEED	AVERAGE LIFE
Subordinate	AA/AAA	265 bp	4.30-4.10%	25-35% CPR	0-1 years
Subordinate	A/AA+	365	5.03-6.30	25-35	0-4
Subordinate	BBB/A+	615	8.80-9.11	25-35	4
Subordinate	BB/BB+	1115	13.80-14.11	25-35	4
Subordinate	B/B	1515	17.80-18.11	25-35	4
Subordinate	Unrated	--	80.03-93.18	25-35	3-4
Interest-only	AAA/AAA	--	0.00	50-60	0-1
Principal-only	AAA/AAA	--	5.00	0	4-14

Discount rates in the market for subordinate securities are typically quoted based on the assumption that the securities will not incur any losses, notwithstanding the fact that market makers expect that these securities will incur losses. The exposure of these securities to credit losses is reflected in the quoted discount rates. Although dealer firms do not typically quote credit loss assumptions, the Company monitors and projects the credit losses on its portfolio. The Company assumes that the mortgage loans in the Hanover 1998-B securitization will default at an annual rate of 0.30% per year, and the Company will recover 75% of the principal balance of the defaulted mortgage loans. Using these assumptions, the quoted prices for the unrated subordinate securities result in an annualized yield of 80% - 93%. This default rate assumption results in projected cumulative losses of \$116,000, or 0.04% of the original principal balance of the mortgage loans in the Hanover 1998-B securitization.

The following tables show the impact of a change of each of the foregoing assumptions on the fair value of the related securities (dollars in thousands):

SENSITIVITY TO DISCOUNT RATE

TYPE OF SECURITY	CHANGE IN DISCOUNT RATE	DECLINE IN VALUE
Subordinate	+100 bp	\$ 177,000
	+200 bp	347,000
Interest-Only	+500 bp	\$ 2,000
	+1000 bp	4,000
Principal-Only	+25 bp	\$ 7,000
	+50 bp	15,000

SENSITIVITY TO PREPAYMENT SPEED

TYPE OF SECURITY	PAYMENT SPEED	DECLINE IN VALUE
Subordinate	25-35% CPR	\$ --
	15-25	139,000
	5-15	291,000
Interest-Only	50-60	\$ --
	60-70	24,000
	70-80	37,000
Principal-Only	0	\$ --

SENSITIVITY TO LOSS ASSUMPTION

TYPE OF SECURITY	ANNUAL DEFAULT RATE	CUMULATIVE LOSSES	DECLINE IN VALUE
Subordinate	0.30%	0.04%	\$ --
	0.90%	0.11%	24,000
	3.00%	0.35%	239,000

The foregoing sensitivity analysis is designed to assist the reader in evaluating the impact that changes in interest rates, prepayment speeds or default rates would have on the value of the securities retained in the Hanover 1998-B securitization. This analysis is based on projected cash flows. The projections were prepared based on a number of simplifying assumptions, including but not limited to the following: (i) all of the loans will prepay at the indicated speeds; (ii) all borrowers pay a full month's interest if they prepay their loans; (iii) there are no delinquencies on the underlying mortgage loans and (iv) the securities are not called. Actual results will differ from projected results.

MANAGED MORTGAGE WHOLE LOANS - The following table presents certain information relating to all mortgage loans securitized by the Company or owned by the Company at December 31, 2002 (dollars in thousands):

MANAGED ASSETS

	PRINCIPAL BALANCE
Mortgage loans held for sale	\$ 547
Mortgage loans collateralizing on-balance sheet CMOs	102,492
Mortgage loans collateralizing off-balance sheet securitization executed by the Company	68,540
Total mortgage loans purchased and managed by the Company	\$ 171,579

	DELINQUENCY RATES
30-59 days delinquent	8.49%
60-89 days delinquent	1.68%
90 or more days delinquent	3.47%
Loans in foreclosure	1.03%
Real estate owned	0.43%

The Company realized credit losses of \$347,000 on the foregoing assets during the year ended December 31, 2002.

11. EMPLOYEE BENEFIT PLANS

401(K) PLAN - The Company participates in the HCP retirement plan ("401(k) Plan"). The 401(k) Plan is available to all full-time company employees with at least 3 months of service. The Company can, at its option, make a discretionary matching contribution to the 401(k) Plan. For the years ended December 31, 2002, 2001 and 2000, expense related to the 401(k) Plan was \$66,487, \$21,444 and \$21,987, respectively. The expense related to the 401(k) Plan for the year ended December 31, 2002 includes \$51,273 for HCP and HT for the six months ended December 31, 2002.

HANOVER STOCK OPTION PLANS - Hanover has adopted two stock option plans: (i) the 1997 Executive and Non-Employee Director Stock Option Plan (the "1997 Stock Option Plan") and (ii) the 1999 Equity Incentive Plan (the "1999 Stock Option Plan", together with the 1997 Stock Option Plan, the "Stock Option Plans"). The purpose of the Stock Option Plans is to provide a means of performance-based compensation in order to attract and retain qualified personnel and to afford additional incentive to others to increase their efforts in providing significant services to the Company.

1997 Stock Option Plan - The 1997 Stock Option Plan provides for the grant of qualified incentive stock options, stock options not so qualified, restricted stock, performance shares, stock appreciation rights and other equity-based compensation. The 1997 Stock Option Plan authorized the grant of options to purchase, and limited stock awards of, an aggregate of up to 325,333 shares of Hanover's common stock.

Of the stock options granted by the Compensation Committee pursuant to the 1997 Stock Option Plan, stock options granted to the Principals to purchase an aggregate of 162,664 shares of Hanover's common stock at Hanover's initial offering price vested ratably over a 48-month period from the date of the grant and, at December 31, 2002, are fully vested. Stock options granted to the non-employee directors to purchase an aggregate of 8,000 shares of Hanover's common stock are exercisable when issued. The remaining stock options granted by the Compensation Committee pursuant to the 1997 Stock Option Plan were contingent and would have vested, subject to other vesting requirements imposed by the Compensation Committee, in full or in part on any September 30 beginning with September 30, 1998 and ending with September 30, 2002 (each, an "Earn-out Measuring Date"). No vesting occurred on any Earn-out Measuring Dates. To maintain a tie between executive compensation and Hanover's corporate performance, effective July 1, 2002, Hanover revised the vesting targets and Earn-out Measuring Dates related to stock options granted to the Principals to purchase an aggregate of 80,160 shares of Hanover's common stock. Hanover cancelled the original options issued to the Principals and reissued new stock options with the same exercise price of \$15.75 but vesting in full or in part on any July 1 beginning with July 1, 2003 and ending with July 1, 2007. The new vesting targets are based on the July 1, 2002 stock price rather than Hanover's initial offering price. All other stock options granted pursuant to the 1997 Stock Option Plan have expired.

1999 Stock Option Plan - The 1999 Stock Option Plan authorizes the grant of options of up to 550,710 shares of Hanover's common stock.

Transactions during the years ended December 31, 2002, 2001 and 2000 relating to the Hanover 1997 and 1999 Stock Option Plans are as follows:

	# OF OPTIONS FOR SHARES		EXERCISE PRICE	WEIGHTED AVERAGE EXERCISE PRICE
	1997 PLAN	1999 PLAN		
Outstanding at December 31, 1999	295,324			\$15.350 =====
		270,250		\$ 4.625 =====
Stock Option Activity - 2000				
Granted - May 18, 2000		282,210	\$3.875	
Cancelled	(6,250)		15.750	
Cancelled	(2,000)		15.940	
Cancelled		(13,750)	3.875	
Cancelled		(17,500)	4.625	
Outstanding at December 31, 2000	287,074			\$15.340 =====
		521,210		\$ 4.240 =====
Stock Option Activity - 2001				
Granted - May 24, 2001		4,000	\$7.750	
Cancelled	(7,750)		15.750	
Cancelled		(3,333)	4.625	
Cancelled		(5,000)	3.875	
Exercised		(36,332)	4.625	
Exercised		(26,566)	3.875	
Outstanding at December 31, 2001	279,324 =====			\$15.330 =====
		453,979		\$ 4.260 =====
Stock Option Activity - 2002				
Granted - May 17, 2002		2,000	9.800	
Reissued - July 1, 2002	80,160		15.750	
Cancelled	(86,160)		15.750	
Cancelled		(6,084)	4.625	
Cancelled		(6,250)	3.875	
Expired	(22,500)		15.750	
Exercised		(126,167)	4.625	
Exercised		(59,443)	3.875	
Outstanding at December 31, 2002	250,824 =====			\$15.283 =====
		258,035 =====		\$ 4.216 =====

At December 31, 2002, 2001 and 2000, 350,878, 383,754 and 253,136 options, respectively, were exercisable, with exercise prices ranging from \$3.875 to \$18.130.

The per share weighted average fair value of stock options granted for the years ended December 31, 2002 and 2001 was \$0.10 and \$1.43, respectively, at the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions:

	2002	2001
Expected life (years)	10	10
Risk-free interest rate	4.79%	5.49%
Volatility	26.38%	32.1%
Expected dividend yield	11.91%	10.3%

Hanover applies APB Opinion No. 25 in accounting for its 1997 and 1999 Stock Option Plans and, accordingly, no compensation cost has been recognized for its stock options in the financial statements for 2002, 2001 and 2000. Had the Company determined compensation cost based on the fair value at the grant date for its stock options under Statement of Financial Accounting Standards No. 123, Accounting For Stock-Based Compensation, the Company's net income would have been reduced to the pro forma amounts for the period indicated below (dollars in thousands, except per share data):

	YEARS ENDED DECEMBER 31,		
	2002	2001	2000
Net earnings:			
As reported	\$ 5,138	\$ 3,160	\$ 2,862
Pro forma	\$ 5,130	\$ 3,154	\$ 2,814
Earnings per share - basic:			
As reported	\$ 1.16	\$ 0.74	\$ 0.56
Pro forma	\$ 1.16	\$ 0.74	\$ 0.55
Earnings per share - diluted:			
As reported	\$ 1.15	\$ 0.73	\$ 0.56
Pro forma	\$ 1.14	\$ 0.73	\$ 0.55

BONUS INCENTIVE COMPENSATION PLAN - A bonus incentive compensation plan was established in 1997, whereby an annual bonus will be accrued for eligible participants of the Company. The annual bonus will be paid one-half in cash and (subject to ownership limits) one-half in shares of common stock in the following year. The Company must generate annual net income before bonus accruals that allows for a return of equity to stockholders in excess of the average weekly ten-year U.S. Treasury rate plus 4.0% before any bonus accrual is recorded. As of December 31, 2002, a bonus accrual of \$198,000 was recorded. No such accrual was recorded in 2001 and 2000.

12. AFFILIATED PARTY TRANSACTIONS

Hanover engaged HCP pursuant to a Management Agreement to render, among other things, due diligence, asset management and administrative services. The term of the Management Agreement continues until December 31, 2003 with subsequent renewal.

The 2002, 2001 and 2000 Consolidated Statements of Income include management and administrative expenses of \$345,000 (for the period January 1 through June 30, 2002), \$716,000 and \$634,000, respectively, relating to billings from HCP. In addition, the 2000 Consolidated Statement of Income includes commission expense of \$4,000. The 2002 (for the period January 1 through June 30, 2002), 2001 and 2000 Consolidated Statements of Income also reflect a reduction in personnel expenses for a portion of salaries allocated (and billed) to HCP.

During 2002, 2001 and 2000, Hanover recorded the following interest income generated from loans to related parties (dollars in thousands):

	YEARS ENDED DECEMBER 31,		
	2002	2001	2000
Principals	\$ 171	\$184	\$185
HCP	40	58	265
HT	265	368	81
HCP-2	277	2	--
Eliminations	(251)	--	--
	=====	=====	=====
	\$ 502	\$612	\$531

13. DERIVATIVE INSTRUMENTS

INTEREST RATE CAPS (CASH FLOW HEDGES & FREESTANDING DERIVATIVE)

From time to time the Company buys interest rate caps when it finances fixed-rate assets with floating-rate reverse repurchase agreements and CMOs. At December 31, 2001, the Company had designated two of its interest rate caps as "cash flow hedges" and one as a "freestanding derivative". During the first quarter of 2002, the Company terminated hedge accounting for one of its cash flow hedges. At the termination date, the loss previously reported in other comprehensive income of \$164,000 was reclassified through earnings. The other cash flow hedge matured in August 2002. Accordingly, at December 31, 2002, the Company had two interest rate caps designated as freestanding derivatives. The objective in entering into these instruments is to protect the net interest margin, which represents the difference between the interest earned on assets and the interest paid on debt. Payments received on the interest rate caps are expected to partially offset increases in interest expense that could result from increases in interest rates. Currently, both interest rate caps are indexed to LIBOR. The Company considers its interest rate caps designated as freestanding derivatives additional protection against the net interest margin although they have not been specifically designated hedging instruments for accounting purposes. The Company did not recognize any gains or losses for the year ended December 31, 2002 as a result of hedge ineffectiveness for the interest rate caps previously designated as cash flow hedges. The Company recognized \$161,000 of losses for the year ended December 31, 2002 in the accompanying Consolidated Statement of Income for changes in the fair value of interest rate caps designated as freestanding derivatives. All of these interest rate caps relate to the payment of variable interest on existing financial instruments. At December 31, 2002, the fair value of the Company's interest rate caps was \$1,000.

FORWARD SALES OF AGENCY SECURITIES (FREESTANDING DERIVATIVES)

For the year ended December 31, 2002, the Company entered into forward sales of government agency guaranteed securities, known as "Agency" securities, and futures contracts to manage the exposure to changes in the value of securities classified as "trading securities." The Company considers these forward sales and futures contracts to be freestanding derivatives. The objective is to offset gains or losses on the trading securities with comparable losses or gains on the forward sales or futures contracts. Generally, changes in the value of the trading securities are caused by changes in interest rates, changes in the market for MBS, and changes in the credit quality of the asset. Changes in interest rates and changes in the market for MBS will also affect the value of the forward sales of Agency securities. Changes in interest rates also affect the value of the futures contracts. (The Company does not attempt to hedge changes in the credit quality of individual assets.) The Company calculates the expected impact that changes in interest rates and the market will have on the price of the trading securities, the forward sales and the futures contracts. Using this information, the Company determines the amount of forward sales or futures contracts that it needs so that the expected gains or losses on trading securities will be offset by comparable losses or gains on the forward sales or futures contracts. The Company marks to market the gain or loss on all of the trading securities and all of the freestanding derivatives in each reporting period. The mark to market on the trading securities is reported as a component of gain on mark to market of mortgage assets, net of associated hedge in the accompanying Consolidated Statement of Income. The mark to market on the freestanding derivatives is reported as a component of other income (loss) in the accompanying Consolidated Statement of Income. The Company realized net losses on forward sales of \$556,000 and on futures contracts of \$753,000 for the year ended December 31, 2002. At December 31 2002, the fair value of the Company's one forward sale of Agency MBS was (\$47,000).

14. STOCKHOLDERS' EQUITY AND EARNINGS PER SHARE

COMMON STOCK

In August 2000, the Board of Directors of Hanover authorized a share repurchase program pursuant to which Hanover is authorized to repurchase up to 1,000,000 shares of its outstanding common stock from time to time in open market transactions at a total cost not to exceed \$3,000,000. During 2000, Hanover repurchased 498,975 shares under the 2000 share repurchase program at an average price of \$5.74 for a total cost of \$2,863,000. Therefore, Hanover has remaining authority to purchase up to 501,025 shares for not more than \$137,000 under the 2000 share repurchase program.

On August 7, 2001, the Board of Directors of Hanover authorized the repurchase of 60,000 shares of its outstanding common stock. On August 13, 2001, Hanover repurchased 57,000 shares under the August 2001 share repurchase authorization at an average price of \$7.03 per share for a total cost of \$401,000. Therefore, Hanover has remaining authority to purchase up to 3,000 shares under the August 2001 share repurchase authorization.

On February 20, 2002, the Board of Directors of Hanover authorized the repurchase of up to 18,166 shares outstanding as a result of exercise of stock option grants prior to the registration of the shares covered by the 1999 Stock Option Plan. As of December 31, 2002, 15,666 shares have been repurchased for approximately \$132,000. Therefore, Hanover has remaining authority to purchase up to 2,500 shares under the 2002 share repurchase authorization.

On January 19, 2001, Hanover's affiliate, HT, hired 18 employees of Pamex and purchased all of Pamex's assets. The purchase price consisted of \$850,000 in cash paid at closing, plus an earn-out of between \$1,250,000 and \$1,500,000 payable over three years in shares of Hanover common stock. The earn-out is based on performance targets. The performance targets for the first two years were met during 2002 and 2001 and \$500,000 was accrued by HT each year. On February 24, 2003, Hanover made a capital contribution to HT of \$75,000 in cash and 60,180 shares of HCHI common stock with a then fair market value of \$457,970. On February 19, 2002, Hanover made a capital contribution of 63,577 shares of Hanover common stock with a then fair market value of \$470,470. The 2002 diluted earnings per share including the 60,180 shares would be \$1.13. The 2001 diluted earnings per share after cumulative effect of adoption of SFAS 133, including the 63,577 shares, would be \$0.72.

The following table summarizes the activity in common stock and additional paid-in capital for 2002, 2001 and 2000 (dollars in thousands except share data):

	COMMON STOCK		ADDITIONAL PAID-IN CAPITAL
	SHARES	AMOUNT	
Balance, December 31, 1999	5,826,899	\$ 58	\$ 75,840
Repurchases on open market pursuant to 1998 share repurchase program	(4,980)	--	(16)
Repurchases on open market pursuant to 1999 share repurchase program	(1,000,000)	(10)	(4,420)
Repurchases on open market pursuant to 2000 share repurchase program	(498,975)	(5)	(2,858)
Balance, December 31, 2000	4,322,944	43	68,546
Repurchases on open market pursuant to April 2001 share repurchase authorization	(189,900)	(2)	(1,333)
Repurchases on open market pursuant to August 2001 share repurchase authorization	(57,000)	--	(400)
Options exercised by employees under 1999 Stock Option Plan	62,898	1	270
Cashless exercise of 1 warrant pursuant to Warrant Agreement with third party	136,734	1	(1)
Balance, December 31, 2001	4,275,676	43	67,082
Repurchases from employees pursuant to February 2002 share repurchase authorization	(15,666)	--	(132)
Settlement of note receivable from officer through common stock repurchase	(34,975)	(1)	(241)
Capital contributed to HT related to first earn-out on Pamex acquisition	63,577	1	469
Options exercised by employees under 1999 Stock Option Plan	185,610	2	812
Balance, December 31, 2002	4,474,222	\$ 45	\$ 67,990

STOCKHOLDER PROTECTION RIGHTS AGREEMENT

In 2000, the Board of Directors approved and adopted the Stockholder Protection Rights Agreement and approved amendments to such agreement in September 2001 and June 2002 (combined, the "Rights Agreement, as amended"). The Rights Agreement, as amended, provides for the distribution of preferred purchase rights ("Rights") to common stockholders. One Right is attached to each outstanding share of common stock and will attach to all subsequently issued shares. Each Right entitles the holder to purchase one one-hundredth of a share (a "Unit") of Participating Preferred Stock at an exercise price of \$17.00 per Unit, subject to adjustment. The Rights separate from the common stock ten days (or a later date approved by the Board of Directors) following the earlier of (a) a public announcement by a person or group of affiliated or associated persons ("Acquiring Person") that such person has acquired beneficial ownership of 10% or more of Hanover's outstanding common shares (more than 20% of the outstanding common stock in the case of John A. Burchett or more than 17% in the case of Wallace Weitz) or (b) the commencement of a tender or exchange offer, the consummation of which would result in an Acquiring Person becoming the beneficial owner of 10% or more of Hanover's outstanding common shares (more than 20% of the outstanding common stock in the case of John A. Burchett or more than 17% in the case of Wallace Weitz).

If, any Acquiring Person holds 10% or more of Hanover's outstanding shares (more than 20% of the outstanding common stock in the case of John A. Burchett or more than 17% in the case of Wallace Weitz) or Hanover is party to a business combination or other specifically defined transaction, each Right (other than those held by the Acquiring Person) will entitle the holder to receive, upon exercise, shares of common stock of the surviving company with a market value equal to two times the exercise price of the Right. The Rights expire in 2010, and are redeemable at the option of a majority of Hanover's Directors at \$0.01 per Right at any time until the tenth day following an announcement of the acquisition of 10% or more of Hanover's common stock.

EARNINGS PER SHARE (dollars in thousands, except per share data)

	YEARS ENDED DECEMBER 31,		
	2002	2001	2000
EARNINGS PER SHARE BASIC:			
Income before cumulative effect of adoption of SFAS 133	\$ 5,138	\$ 3,114	\$ 2,862
Cumulative effect of adoption of SFAS 133	--	46	--
Net income (numerator)	\$ 5,138	\$ 3,160	\$ 2,862
Average common shares outstanding (denominator)	4,417,221	4,256,874	5,102,563
Per share:			
Before cumulative effect of adoption of SFAS 133	\$ 1.16	\$ 0.73	\$ 0.56
Cumulative effect of adoption of SFAS 133	--	0.01	--
After cumulative effect of adoption of SFAS 133	\$ 1.16	\$ 0.74	\$ 0.56
EARNINGS PER SHARE DILUTED:			
Income before cumulative effect of adoption of SFAS 133	\$ 5,138	\$ 3,114	\$ 2,862
Cumulative effect of adoption of SFAS 133	--	46	--
Net income (numerator)	\$ 5,138	\$ 3,160	\$ 2,862
Average common shares outstanding	4,417,221	4,256,874	5,102,563
Add: Incremental shares from assumed conversion of warrants	--	--	24,170
Incremental shares from assumed conversion of stock options	63,523	53,758	407
Dilutive potential common shares	63,523	53,758	24,577
Diluted weighted average shares outstanding (denominator)	4,480,744	4,310,632	5,127,140
Per share:			
Before cumulative effect of adoption of SFAS 133	\$ 1.15	\$ 0.72	\$ 0.56
Cumulative effect of adoption of SFAS 133	--	0.01	--
After cumulative effect of adoption of SFAS 133	\$ 1.15	\$ 0.73	\$ 0.56

15. SUPPLEMENTAL DISCLOSURES FOR STATEMENTS OF CASH FLOWS

(dollars in thousands, except share data)

	YEARS ENDED DECEMBER 31,		
	2002	2001	2000
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION			
Cash paid during the period for:			
Income taxes	\$ 11	\$ --	\$ --
Interest	\$ 8,092	\$ 14,135	\$20,666
SUPPLEMENTAL SCHEDULE OF NON-CASH ACTIVITIES			
Dividends declared in December but not paid until the following year	\$ 1,119	\$ 855	\$ 865
Payment of note receivable from related party with Hanover common stock	\$ 242	\$ --	\$ --
Transfer of mortgage loans to real estate owned	\$ 369	\$ --	\$ --
Acquisition of common stock of subsidiaries from related parties in exchange for reduction of notes receivable from related parties	\$ 474	\$ --	\$ --
Capital contribution of 63,577 shares of common stock to HT	\$ 470	\$ --	\$ --
Cashless exercise of 1 warrant in exchange for 136,734 shares of common stock	\$ --	\$ 1	\$ --
INCREASE IN CASH DUE TO ACQUISITION OF SUBSIDIARIES' RESIDUAL INTERESTS			
Total negative equity of subsidiaries prior to acquisition	\$ (1,816)	\$ --	\$ --
Less net liabilities of subsidiaries prior to acquisition, excluding cash	(3,487)	--	--
Net increase in cash due to acquisition of subsidiaries' residual interests	\$ 1,671	\$ --	\$ --

16. SEGMENT REPORTING

As discussed in Note 1 to the Consolidated Financial Statements, the Company is engaged in three principal businesses which are conducted through its three primary operating units, each a reportable segment: Hanover, HCP and HT. The principal business strategy of Hanover is to invest in MBS and mortgage loans for its own account, and, commencing in 2001, for third parties. The principal business strategy of HCP is to generate consulting and other fee income by providing consulting and due diligence services, focusing on loan sale advisory, loan file due diligence reviews, staffing solutions and mortgage assignment and collateral rectification services. HCP also services multifamily mortgage loans and owns a registered broker/dealer; these two activities are not material and are combined with HCP for purposes of segment reporting. The principal business activity of HT is to generate fee income by operating an Internet exchange for trading mortgage loans, mortgage servicing rights and related assets, and providing state-of-the-art technologies supported by experienced valuation, operations and trading professionals. HT also owns a broker/dealer whose activities are not material and are combined with HT for segment reporting purposes.

As discussed in Note 7 to the Consolidated Financial Statements, prior to June 30, 2002, HCP and HT were unconsolidated subsidiaries. Therefore, segment information is only being provided for 2002 as follows (dollars in thousands):

	Hanover Capital Mortgage Holdings, Inc.	Hanover Capital Partners Ltd.	Hanover Trade, Inc.	Other	Elimina- tions	Consolidated
Net interest income	\$ 5,973	\$ 12	\$ 6	\$ 352	\$ (251)	\$ 6,092
Other revenues (loss)	2,316	4,348	3,164	(160)	(5)	9,663
Net income (loss)	5,138	482	(913)	44	387	5,138
Total assets	154,381	3,706	4,346	24	(6,586)	155,871
Capital expenditures and investments	6,391	35	710	--	--	7,136
Depreciation and amortization	3	27	625	--	--	655

17. COMMITMENTS AND CONTINGENCIES

Hanover entered into employment agreements with the Principals and Mr. Kaplan. Such agreements provided for initial five-year terms, and provided for initial aggregate annual base salaries of \$1,200,000 (subject to cost of living increases). Mr. Kaplan's agreement will terminate on December 31, 2006. However, pursuant to the amendments upon the expiration of the initial term, the term of each contract for the Principals would be automatically extended on its anniversary for a one-year period, unless either party gives notice to the contrary. Effective July 1, 2002, Hanover entered into an Amended and Restated Employment Agreement with each of the Principals. These employment agreements are substantially identical to the previous employment agreement with each of these officers, except that (i) the base salary was set at the officer's current salary as of July 1, 2002; and (ii) each agreement has a five-year term, automatically renewing for successive one-year terms thereafter until Hanover or the officer terminates the agreement. During 2002, 2001 and 2000, a portion of the aggregate base salaries was allocated to Hanover's principal taxable subsidiaries, HCP and HT, based on management's actual and estimated time involved with the subsidiary's activities.

As additional consideration to the Principals for their contribution of their HCP preferred stock to Hanover, Hanover has agreed, pursuant to a Contribution Agreement, to (i) issue to the Principals up to 216,667 additional shares of Hanover's common stock and (ii) forgive a maximum of \$1,750,000 in loans made to the Principals if certain financial returns to stockholders are met based on its initial offering price over certain performance periods, the last of which would have ended on September 30, 2002. None of the targets were met within the first four periods, so no Earn-Out Shares have been issued and none of the loans have been forgiven. In accordance with Hanover's policy of tying executive compensation to its corporate performance, effective July 1, 2002, Hanover has entered into Amendment No. 1 to the Contribution Agreement. As a result, the shares could be issued, and the loans could be forgiven, in performance periods between 2002 and 2007 if Hanover meets new performance targets based on its July 1, 2002 market price rather than its initial offering price.

In October 1998, the Company sold 15 adjustable-rate FNMA certificates and 19 fixed-rate FNMA certificates that the Company received in a swap for certain adjustable-rate and fixed-rate mortgage loans. These securities were sold with recourse. Accordingly, the Company retains credit risk with respect to the principal amount of these mortgage securities.

At December 31, 2002, the Company had forward commitments to sell \$4.5 million (par value) and one forward commitment to buy \$4.5 million of Agency mortgage securities that had not yet settled. These forward commitments were entered into to partially hedge the expected sale of approximately \$3.4 million principal balance of subordinate MBS classified as trading. At December 31, 2002, the fair value of the Company's one forward sale of Agency MBS was (\$47,000).

The Company has noncancelable operating lease agreements for office space. Future minimum rental payments for such leases are as follows (dollars in thousands):

YEAR	AMOUNT
-----	-----
2003	\$ 402
2004	343
2005	143
2006	46
2007	35
Thereafter	--

	\$ 969
	=====

Rent expense for the years ended December 31, 2002, 2001 and 2000 amounted to \$239,000, \$110,000 and \$107,000, respectively. The rent expense for the year ended December 31, 2002 includes \$182,000 for HCP and HT for the six months ended December 31, 2002.

18. FINANCIAL INSTRUMENTS

The estimated fair value of the Company's assets and liabilities classified as financial instruments and off-balance sheet financial instruments at December 31, 2002 and 2001 are as follows (dollars in thousands):

	DECEMBER 31, 2002		DECEMBER 31, 2001	
	CARRYING AMOUNT	FAIR VALUE	CARRYING AMOUNT	FAIR VALUE
	-----	-----	-----	-----
Assets:				
Mortgage loans:				
Held for sale	\$ 413	\$ 413	\$ 2,391	\$ 2,391
Collateral for CMOs	102,751	103,251	151,882	151,295
Mortgage securities pledged as collateral for reverse repurchase agreements:				
Available for sale	4,082	4,082	4,404	4,404
Held to maturity	559	481	768	709
Trading	2,669	2,669	33,182	33,182
Mortgage securities pledged as collateral for CMOs	9,805	11,044	9,840	9,576
Mortgage securities not pledged:				
Available for sale	6,186	6,186	1,162	1,162
Trading	602	602	1,827	1,827
Interest rate caps	1	1	49	49
Forward commitments to sell mortgage securities	(47)	(47)	28	28
Cash and cash equivalents	10,605	10,605	8,946	8,946
Accrued interest receivable	960	960	1,960	1,960
Notes receivable from related parties	2,563	2,563	12,538	12,538
	-----	-----	-----	-----
Total	\$ 141,149	\$ 142,810	\$228,977	\$228,067
	=====	=====	=====	=====
Liabilities:				
Reverse repurchase agreements	\$ 6,283	\$ 6,283	\$ 33,338	\$ 33,338
CMO borrowing	102,589	104,595	151,096	149,865
Accounts payable, accrued expenses and other liabilities	2,816	2,816	2,677	2,677
	-----	-----	-----	-----
Total	\$ 111,688	\$ 113,694	\$187,111	\$185,880
	=====	=====	=====	=====

The following methods and assumptions were used to estimate the fair value of the Company's financial instruments:

Mortgage loans - The fair values of these financial instruments are based upon actual prices received upon recent sales of loans and securities to investors and projected prices which could be obtained through investors considering interest rates, loan type, and credit quality.

Mortgage securities - The fair values of these financial instruments are based upon either or all of the following: actual prices received upon recent sales of securities to investors, projected prices which could be obtained through investors, estimates considering interest rates, loan type, quality and discounted cash flow analysis based on prepayment and interest rate assumptions used in the market place for similar securities with similar credit ratings.

Cash and cash equivalents, accrued interest receivable, notes receivable from related parties, reverse repurchase agreements and accounts payable, accrued expenses and other liabilities - The fair value of these financial instruments was determined to be their carrying value due to their short-term nature.

CMO borrowing - The fair values of these financial instruments are based upon either or all of the following: actual prices received upon recent sales of securities to investors, projected prices which could be obtained through investor estimates considering interest rates, loan type, quality and discounted cash flow analysis based on prepayment and interest rate assumptions used in the market place for similar securities with similar credit ratings.

Interest rate caps - The fair values of these financial instruments are estimated based on dealer quotes and is the estimated amount the Company would pay to execute a new agreement with similar terms.

Forward commitments to sell securities - The Company has outstanding forward commitments to sell mortgage securities into mandatory delivery contracts with investment bankers, private investors and agency-backed securities. The fair value of these financial instruments was determined through review of published market information associated with similar instruments. These commitment obligations are considered in conjunction with the Company's lower of cost or market valuation of its loans held for sale.

19. SUBSEQUENT EVENTS

On January 14, 2003, a \$0.25 cash dividend, previously declared by the Board of Directors, was paid to stockholders of record as of December 31, 2002. On February 20, 2003, an extra one-time \$0.15 cash dividend was declared by the Board of Directors to be paid on March 20, 2003 to stockholders of record as of March 6, 2003.

During December 2002, Hanover exercised the call provisions of its 1998-A securitization. In February 2003, Hanover sold the underlying mortgage loans and realized aggregate net proceeds of approximately \$1,000,000 which will be available for re-investment. As of December 31, 2002, Group 3 of Hanover's 1998-B securitization was callable. During January 2003, Hanover exercised the call provisions of its 1998-B securitization and in March 2003, sold the underlying mortgage loans and realized aggregate net proceeds of approximately \$5,000,000.

On February 21, 2003, the maturity date of the notes payable from HCP and HT were extended from March 31, 2003 to March 31, 2004.

In February 2003, the Company made a capital contribution to HT of \$75,000 of cash and 60,180 shares of Hanover common stock with a then fair market value of \$457,970. The capital contribution was utilized by HT to fund the second earn-out issued in connection with HT's purchase in January 2001 of all of the assets of Pamex.

On February 25, 2003, Hanover issued options to purchase 30,000 shares of its common stock with an exercise price of \$7.69 in satisfaction of the terms of the purchase agreement between HT and Pamex. The stock options expire on February 24, 2008.

In March 2003, the Company renewed its \$10 million committed reverse repurchase line of credit; this committed line matures on April 27, 2003.

20. QUARTERLY FINANCIAL DATA - UNAUDITED

(dollars in thousands, except per share data)

	THREE MONTHS ENDED			
	DECEMBER 31, 2002	SEPTEMBER 30, 2002	JUNE 30, 2002	MARCH 31, 2002
Net interest income	\$ 1,520	\$ 1,539	\$ 1,381	\$ 1,652
Net income	\$ 928	\$ 1,506	\$ 1,392	\$ 1,312
Basic earnings per share (1)	\$ 0.21	\$ 0.34	\$ 0.32	\$ 0.31
Diluted earnings per share (1)	\$ 0.20	\$ 0.33	\$ 0.31	\$ 0.30
Dividends declared	\$ 0.25	\$ 0.25	\$ 0.25	\$ 0.25

	THREE MONTHS ENDED			
	DECEMBER 31, 2001	SEPTEMBER 30, 2001	JUNE 30, 2001	MARCH 31, 2001
Net interest income	\$ 1,658	\$ 1,607	\$ 1,674	\$ 1,330
Net income	\$ 1,066	\$ 725	\$ 696	\$ 673
Basic earnings per share (1)	\$ 0.25	\$ 0.17	\$ 0.17	\$ 0.16
Diluted earnings per share (1)	\$ 0.25	\$ 0.17	\$ 0.16	\$ 0.15
Dividends declared	\$ 0.20	\$ 0.20	\$ 0.20	\$ 0.20

	THREE MONTHS ENDED			
	DECEMBER 31, 2000	SEPTEMBER 30, 2000	JUNE 30, 2000	MARCH 31, 2000
Net interest income	\$ 1,673	\$ 2,081	\$ 1,425	\$ 1,484
Net income	\$ 710	\$ 727	\$ 735	\$ 690
Basic earnings per share (1)	\$ 0.16	\$ 0.15	\$ 0.14	\$ 0.12
Diluted earnings per share (1)	\$ 0.15	\$ 0.15	\$ 0.14	\$ 0.12
Dividends declared	\$ 0.20	\$ 0.20	\$ 0.14	\$ 0.12

(1) Earnings per share are computed independently for each of the quarters presented; therefore the sum of the quarterly earnings per share does not equal the earnings per share total for the year.

21. PRO FORMA DISCLOSURE

The following unaudited pro forma consolidated statements of income have been prepared to give effect to Hanover's acquisition on July 1, 2002 of 100% of the outstanding common stock of each of HCP, HT and HCP-2 (collectively, the "Newly Consolidated Subsidiaries"), as previously reported on Form 8-K filed on July 16, 2002. This acquisition had been accounted for using the purchase method of accounting. These pro forma consolidated statements of income were prepared as if the acquisition had been completed as of January 1, 2001.

The unaudited pro forma consolidated statements of income are presented for illustrative purposes only and are not necessarily indicative of the results of operations that would have actually been reported had the acquisition occurred on January 1, 2001, nor are these presentations necessarily indicative of the future results of operations.

These unaudited pro forma consolidated statements of income are based upon the historical consolidated financial statements of Hanover and the Newly Consolidated Subsidiaries included in Hanover's Annual Report on Form 10-K for the year ended December 31, 2001 and the Quarterly Report on Form 10-Q for the six months ended June 30, 2002.

Information presented for the years ended December 31, 2002 and 2001 is presented on a consolidated pro forma basis.

HANOVER CAPITAL MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES
PRO FORMA CONSOLIDATED STATEMENTS OF INCOME
(in thousands, except per share data)
(unaudited)

	YEARS ENDED DECEMBER 31,	
	2002	2001
	(Pro Forma)	(Pro Forma)
REVENUES:		
Interest income	\$13,813	\$ 19,304
Interest expense	7,438	13,433
Net interest income	6,375	5,871
Loan loss provision	393	709
Net interest income after loan loss provision	5,982	5,162
Gain on sale of mortgage assets	2,095	3,782
Gain on mark to market of mortgage assets, net of associated hedge	1,237	695
Loan brokering, trading and advisory services	6,831	3,521
Due diligence fees	4,971	5,083
Assignment fees	2,220	757
Other income (loss)	(399)	58
Total revenue	22,937	19,058
EXPENSES:		
Personnel	8,907	7,231
Subcontractor	2,964	2,373
Depreciation and amortization	1,280	1,184
Legal and professional	1,206	1,704
General and administrative	1,181	1,152
Technology	782	683
Occupancy	536	651
Travel and entertainment	512	548
Other	437	461
Total expenses	17,805	15,987
Operating income	5,132	3,071
Equity in income of unconsolidated subsidiaries:		
Hanover Capital Partners Ltd.	--	--
HanoverTrade, Inc.	--	--
HDMF-I LLC	157	(35)
Hanover Capital Partners 2, Inc.	--	--
Income before income tax provision (benefit) and cumulative effect of adoption of SFAS 133	5,289	3,036
Income tax provision (benefit)	127	64
Income before cumulative effect of adoption of SFAS 133	5,162	2,972
Cumulative effect of adoption of SFAS 133	--	46
NET INCOME	\$ 5,162	\$ 3,018
BASIC EARNINGS PER SHARE:		
Before cumulative effect of adoption of SFAS 133	\$ 1.17	\$ 0.70
Cumulative effect of adoption of SFAS 133	--	.01
After cumulative effect of adoption of SFAS 133	\$ 1.17	\$ 0.71
DILUTED EARNINGS PER SHARE:		
Before cumulative effect of adoption of SFAS 133	\$ 1.15	\$ 0.69
Cumulative effect of adoption of SFAS 133	--	.01
After cumulative effect of adoption of SFAS 133	\$ 1.15	\$ 0.70

See notes to pro forma consolidated statements of income

HANOVER CAPITAL MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES
PRO FORMA CONSOLIDATED STATEMENT OF INCOME
YEAR ENDED DECEMBER 31, 2002
(UNAUDITED)
(in thousands, except per share data)

	HANOVER CAPITAL MORTGAGE HOLDINGS, INC. AS REPORTED	SIX MONTHS ENDED JUNE 30, 2002 NEWLY CONSOLIDATED SUBSIDIARIES	ADJUSTMENTS/ ELIMINATIONS	PRO FORMA CONSOLIDATED
	-----	-----	-----	-----
REVENUES:				
Interest income	\$ 13,530	\$ 639	\$(356) (a, d)	\$ 13,813
Interest expense	7,438	--	--	7,438
	-----	-----	-----	-----
Net interest income	6,092	639	(356)	6,375
Loan loss provision	393	--	--	393
	-----	-----	-----	-----
Net interest income after loan loss provision	5,699	639	(356)	5,982
Gain on sale of mortgage assets	2,095	--	--	2,095
Gain (loss) on mark to market of mortgage assets	1,367	(130)	--	1,237
Loan brokering, trading and advisory services	2,686	4,145	--	6,831
Due diligence fees	2,891	2,087	(7) (b)	4,971
Assignment fees	1,387	833	--	2,220
Other income (loss)	(370)	7	(36) (b)	(399)
	-----	-----	-----	-----
Total revenue	15,755	7,581	(399)	22,937
	-----	-----	-----	-----
EXPENSES:				
Personnel	5,479	3,083	345 (b, d)	8,907
Subcontractor	1,812	1,152	--	2,964
Depreciation and amortization	655	625	--	1,280
Legal and professional	1,070	136	--	1,206
General and administrative	1,089	505	(413) (b)	1,181
Technology	293	489	--	782
Occupancy	349	187	--	536
Travel and entertainment	317	195	--	512
Other	409	359	(331) (a)	437
	-----	-----	-----	-----
Total expenses	11,473	6,731	(399)	17,805
	-----	-----	-----	-----
Operating income	4,282	850	--	5,132
Equity in income of unconsolidated subsidiaries	905	--	(748) (c)	157
	-----	-----	-----	-----
Income before income tax provision (benefit)	5,187	850	(748)	5,289
Income tax provision (benefit)	49	78	--	127
	-----	-----	-----	-----
NET INCOME	\$ 5,138	\$ 772	\$(748)	\$ 5,162
	=====	=====	=====	=====
BASIC EARNINGS PER SHARE:				
Average common shares outstanding	4,417,221			4,417,221
	=====			=====
Basic earnings per share	\$ 1.16			\$ 1.17
	=====			=====
DILUTED EARNINGS PER SHARE:				
Diluted weighted average shares outstanding	4,480,744			4,480,744
	=====			=====
Diluted earnings per share	\$ 1.15			\$ 1.15
	=====			=====

See notes to pro forma consolidated statements of income

HANOVER CAPITAL MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES
PRO FORMA CONSOLIDATED STATEMENT OF INCOME
YEAR ENDED DECEMBER 31, 2001
(UNAUDITED)
(in thousands, except per share data)

	HANOVER CAPITAL MORTGAGE HOLDINGS, INC. AS REPORTED	NEWLY CONSOLIDATED SUBSIDIARIES	ADJUSTMENTS/ ELIMINATIONS	PRO FORMA CONSOLIDATED
	-----	-----	-----	-----
REVENUES:				
Interest income	\$ 19,702	\$ 55	\$ (453)(a, d)	\$ 19,304
Interest expense	13,433	--	--	13,433
	-----	-----	-----	-----
Net interest income	6,269	55	(453)	5,871
Loan loss provision	709	--	--	709
	-----	-----	-----	-----
Net interest income after loan loss provision	5,560	55	(453)	5,162
Gain on sale of mortgage assets	3,782	--	--	3,782
Gain on mark to market of mortgage assets, net of associated hedge	751	(56)	--	695
Loan brokering, trading and advisory services	--	3,521	--	3,521
Due diligence fees	--	5,803	(720)(b)	5,083
Assignment fees	--	757	--	757
Other income(loss)	(28)	86	--	58
	-----	-----	-----	-----
Total revenue	10,065	10,166	(1,173)	19,058
	-----	-----	-----	-----
EXPENSES:				
Personnel	680	6,555	(4)(b)	7,231
Subcontractor	--	2,373	--	2,373
Depreciation and amortization	24	1,160	--	1,184
Legal and professional	1,247	457	--	1,704
General and administrative	1,132	736	(716)(b)	1,152
Technology	4	679	--	683
Occupancy	151	500	--	651
Other	413	479	(428)(a)	464
Travel and entertainment	45	500	--	545
	-----	-----	-----	-----
Total expenses	3,696	13,439	(1,148)	15,987
	-----	-----	-----	-----
Operating income(loss)	6,369	(3,273)	(25)	3,071
Equity in(loss) of unconsolidated subsidiaries	(3,255)	--	3,220(d)	(35)
	-----	-----	-----	-----
Income(loss) before income tax provision and cumulative effect of adoption of SFAS 133	3,114	(3,273)	3,195	3,036
Income tax provision	--	64	--	64
	-----	-----	-----	-----
Income(loss) before cumulative effect of adoption of SFAS 133	3,114	(3,337)	3,195	2,972
Cumulative effect of adoption of SFAS 133	46	--	--	46
	-----	-----	-----	-----
NET INCOME(LOSS)	\$ 3,160	\$ (3,337)	\$ 3,195	\$ 3,018
	=====	=====	=====	=====
BASIC EARNINGS PER SHARE:				
Average common shares outstanding	4,256,874			4,256,874
	=====			=====
Basic earnings per share:				
Before cumulative effect of adoption of SFAS 133	\$ 0.73			\$ 0.70
Cumulative effect of adoption of SFAS 133	0.01			0.01
	-----			-----
After cumulative effect of adoption of SFAS 133	\$ 0.74			\$ 0.71
	=====			=====
DILUTED EARNINGS PER SHARE:				
Diluted weighted average shares outstanding	4,310,632			4,310,632
	=====			=====
Diluted earnings per share:				
Before cumulative effect of adoption of SFAS 133	\$ 0.72			\$ 0.69
Cumulative effect of adoption of SFAS 133	0.01			0.01
	-----			-----
After cumulative effect of adoption of SFAS 133	\$ 0.73			\$ 0.70
	=====			=====

See notes to pro forma consolidated statements of income

HANOVER CAPITAL MORTGAGE HOLDINGS, INC. AND SUBSIDIARIES
 NOTES TO PRO FORMA CONSOLIDATED STATEMENTS OF INCOME
 (UNAUDITED)
 (dollars in thousands)

(a) To eliminate intercompany interest income and expense summarized as follows:

	SIX MONTHS ENDED JUNE 30, 2002	YEAR ENDED DECEMBER 31, 2001
	-----	-----
Interest on note to Hanover Capital Partners Ltd.	\$ 23	\$ 58
Interest on note to HanoverTrade, Inc.	146	368
Interest on note to Hanover Capital Partners 2, Inc.	162	2
	-----	-----
	\$ 331	\$ 428
	=====	=====

(b) Hanover engaged Hanover Capital Partners Ltd. pursuant to a Management Agreement to render, among other things, due diligence, asset management and administrative services. In addition, Hanover Capital Partners Ltd. performed management and administrative services for HanoverTrade, Inc. To eliminate these intercompany management fees recorded as follows:

	SIX MONTHS ENDED JUNE 30, 2002	YEAR ENDED DECEMBER 31, 2001
	-----	-----
Management fee income recorded to:		
Due diligence fees	\$ 7	\$ 720
Other revenues	36	--
Reduction of personnel expense	374	--
	-----	-----
	\$ 417	\$ 720
	=====	=====
Management fee expensed to:		
General, management and administrative	\$ 413	\$ 716
Personnel expense	4	4
	-----	-----
	\$ 417	\$ 720
	=====	=====

(c) With the consolidation of the results of Hanover Capital Partners Ltd., HanoverTrade, Inc. and Hanover Capital Partners 2, Inc., the equity in income (loss) of these subsidiaries summarized below would be reversed:

	SIX MONTHS ENDED JUNE 30, 2002	YEAR ENDED DECEMBER 31, 2001
	-----	-----
Hanover Capital Partners Ltd.	\$ 112	\$ 43
HanoverTrade, Inc.	655	(3,263)
Hanover Capital Partners 2, Inc.	(19)	--
	-----	-----
	\$ 748	\$(3,220)
	=====	=====

(d) To exclude the interest income on the portion of the notes receivable reduced in exchange for the purchase of the common stock of the newly consolidated subsidiaries; interest for the year ended December 31, 2002 was forgiven and the offset is to personnel expense while for the year ended December 31, 2001, the offset is to the balance sheet.

	YEARS ENDED DECEMBER 31,	
	-----	-----
	2002	2001
	-----	-----
Interest income	\$ 25	\$ 25
	=====	=====
Personnel expense	\$ (25)	\$ --
	=====	=====

INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Hanover Capital Partners Ltd. and Subsidiaries
Edison, New Jersey

We have audited the accompanying consolidated balance sheets of Hanover Capital Partners Ltd. and Subsidiaries (the "Company") as of December 31, 2002 and 2001, and the related consolidated statements of income, stockholder's equity, and cash flows for each of the three years in the period ended December 31, 2002. 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 auditing standards generally accepted in the United States of America. 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, such consolidated financial statements present fairly, in all material respects, the financial position of Hanover Capital Partners Ltd. and Subsidiaries at December 31, 2002 and 2001, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America.

DELOITTE & TOUCHE LLP
Parsippany, New Jersey
March 20, 2003

HANOVER CAPITAL PARTNERS LTD. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	DECEMBER 31,	
ASSETS	2002	2001
CURRENT ASSETS:		
Cash and cash equivalents	\$ 368,715	\$ 847,676
Accounts receivable	1,415,159	996,777
Receivables from related parties	363,687	473,637
Accrued revenue on contracts in progress	895,303	1,035,870
Prepaid expenses and other current assets	110,852	39,580
Total current assets	3,153,716	3,393,540
PROPERTY AND EQUIPMENT - Net	91,931	100,584
DEFERRED TAX ASSET - Net	239,678	294,041
MORTGAGE LOANS HELD FOR SALE	207,151	--
OTHER ASSETS	13,340	13,340
TOTAL ASSETS	\$ 3,705,816	\$ 3,801,505
LIABILITIES AND STOCKHOLDER'S EQUITY		
CURRENT LIABILITIES:		
Accrued appraisal and subcontractor costs	\$ 34,612	\$ 16,139
Accounts payable and accrued expenses	259,280	456,859
Due to related parties	14,841	411,232
Deferred revenue	10,000	--
Income tax payable	38,160	--
Total current liabilities	356,893	884,230
NOTE PAYABLE TO RELATED PARTY	870,298	1,035,859
TOTAL LIABILITIES	1,227,191	1,920,089
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDER'S EQUITY:		
Preferred stock: \$.01 par value, 100,000 shares authorized, 97,000 shares outstanding at December 31, 2002 and 2001	970	970
Common stock: Class A: \$.01 par value, 5,000 shares authorized, 3,000 shares outstanding at December 31, 2002 and 2001	30	30
Additional paid-in capital	2,839,947	2,839,947
Retained earnings (deficit)	(362,322)	(959,531)
TOTAL STOCKHOLDER'S EQUITY	2,478,625	1,881,416
TOTAL LIABILITIES AND STOCKHOLDER'S EQUITY	\$ 3,705,816	\$ 3,801,505

See notes to consolidated financial statements

HANOVER CAPITAL PARTNERS LTD. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

	YEARS ENDED DECEMBER 31,		
	2002	2001	2000
REVENUES:			
Due diligence fees	\$4,977,620	\$5,802,720	\$7,016,435
Assignment fees	2,220,083	756,683	631,093
Interest income on mortgage assets, net of interest expense and loan loss provision of \$1,137,499 in 2000	872	--	513,391
Gain on sale of mortgage securities	--	--	440,639
Other income	184,733	22,957	112,100
Total revenues	7,383,308	6,582,360	8,713,658
EXPENSES:			
Subcontractor	2,950,378	2,373,226	3,081,029
Personnel	2,688,339	2,956,008	3,152,852
General and administrative	330,423	311,083	309,926
Occupancy	260,414	243,888	453,372
Travel and subsistence	197,853	224,296	215,959
Professional	161,899	242,173	257,495
Depreciation and amortization	57,965	57,970	52,908
Interest	40,347	65,555	90,054
Total expenses	6,687,618	6,474,199	7,613,595
INCOME BEFORE INCOME TAX PROVISION	695,690	108,161	1,100,063
INCOME TAX PROVISION	98,481	64,149	631,722
NET INCOME	\$ 597,209	\$ 44,012	\$ 468,341
BASIC EARNINGS PER SHARE (NOTE 2)	\$ 199.07	\$ 14.67	\$ 156.11

See notes to consolidated financial statements

HANOVER CAPITAL PARTNERS LTD. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDER'S EQUITY
YEARS ENDED DECEMBER 31, 2002, 2001 AND 2000

	PREFERRED STOCK		COMMON STOCK		ADDITIONAL PAID-IN CAPITAL
	SHARES	AMOUNT	SHARES	AMOUNT	
BALANCE, DECEMBER 31, 1999	97,000	\$ 970	3,000	\$ 30	\$ 2,839,947
Comprehensive income:					
Net income					
Other comprehensive income (loss):					
Change in net unrealized gain on securities available for sale, net of income tax effect					
Comprehensive income					
BALANCE, DECEMBER 31, 2000	97,000	970	3,000	30	2,839,947
Comprehensive income:					
Net income					
Comprehensive income					
BALANCE, DECEMBER 31, 2001	97,000	970	3,000	30	2,839,947
Comprehensive income:					
Net income					
Comprehensive income					
BALANCE, DECEMBER 31, 2002	97,000	\$ 970	3,000	\$ 30	\$ 2,839,947

	COMPREHENSIVE INCOME (LOSS)	RETAINED EARNINGS (DEFICIT)	ACCUMULATED OTHER COMPREHENSIVE GAIN	TOTAL
BALANCE, DECEMBER 31, 1999		\$(1,471,884)	\$ 142,311	\$ 1,511,374
Comprehensive income:				
Net income	\$ 468,341	468,341		468,341
Other comprehensive income (loss):				
Change in net unrealized gain on securities available for sale, net of income tax effect	(142,311)		(142,311)	(142,311)
Comprehensive income	\$ 326,030			
BALANCE, DECEMBER 31, 2000		(1,003,543)	--	1,837,404
Comprehensive income:				
Net income	\$ 44,012	44,012		44,012
Comprehensive income	\$ 44,012			
BALANCE, DECEMBER 31, 2001		(959,531)	--	1,881,416
Comprehensive income:				
Net income	\$ 597,209	597,209		597,209
Comprehensive income	\$ 597,209			
BALANCE, DECEMBER 31, 2002		\$ (362,322)	\$ --	\$ 2,478,625

See notes to consolidated financial statements

HANOVER CAPITAL PARTNERS LTD. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	YEARS ENDED DECEMBER 31,		
	2002	2001	2000
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	\$ 597,209	\$ 44,012	\$ 468,341
Adjustments to reconcile net income to net cash (used in) provided by operating activities:			
Amortization of net premium	--	--	(374,961)
Loan loss provision	--	--	478,330
Depreciation and amortization	57,965	53,875	42,798
Deferred tax provision	54,363	46,690	612,682
Gain on sale of mortgage-backed securities	--	--	(440,639)
Gain on disposal of property and equipment	--	--	(2,700)
Sale of trading securities	--	--	15,755
Changes in assets - (increase) decrease:			
Accounts receivable	(418,382)	1,305,434	(1,633,218)
Receivables from/payables to related parties	(286,441)	469,710	(345,146)
Accrued interest receivable	--	--	181,471
Accrued revenue on contracts in progress	140,567	311,696	(585,643)
Prepaid expenses and other current assets	(71,272)	(13,024)	143,645
Other assets	--	3,690	161,903
Changes in liabilities - increase (decrease):			
Accrued appraisal and subcontractor costs	18,473	(20,640)	23,197
Accounts payable and accrued expenses	(197,579)	(1,085,149)	1,033,033
Deferred revenue	10,000	(5,276)	5,276
Income tax payable	38,160	(20,828)	20,828
Net cash (used in) provided by operating activities	(56,937)	1,090,190	(195,048)
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchases of property and equipment	(49,312)	(67,742)	(72,914)
Sale of property and equipment	--	--	2,700
Purchase of mortgage loans from affiliate	(208,274)	--	--
Purchase of mortgage securities	--	--	(8,450,259)
Proceeds from sale of mortgage securities to third parties	--	--	8,667,260
Proceeds from sale of mortgage securities to affiliate	--	--	13,844,223
Principal payments received on mortgage assets	1,123	--	216,649
Net cash (used in) provided by investing activities	(256,463)	(67,742)	14,207,659
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net repayment of note payable to related party	(165,561)	(668,483)	(3,191,704)
Net repayment of reverse repurchase agreements	--	--	(10,842,000)
Net cash used in financing activities	(165,561)	(668,483)	(14,033,704)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(478,961)	353,965	(21,093)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	847,676	493,711	514,804
CASH AND CASH EQUIVALENTS, END OF YEAR	\$ 368,715	\$ 847,676	\$ 493,711
SUPPLEMENTAL CASH FLOW INFORMATION:			
Cash paid during the year for:			
Income taxes	\$ 5,956	\$ 60,518	\$ 3,435
Interest	\$ 85,682	\$ 43,936	\$ 830,930

See notes to consolidated financial statements

HANOVER CAPITAL PARTNERS LTD. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2002, 2001 AND 2000

1. BUSINESS DESCRIPTION

Hanover Capital Partners Ltd. ("HCP") and its subsidiaries operate as a specialty finance company which is principally engaged in providing consulting and due diligence services, focusing on loan sale advisory, loan file due diligence reviews, staffing solutions and mortgage assignment and collateral rectification services. Beginning in 2002, HCP began providing asset management services to an affiliate, HDMF-I LLC ("HDMF-I"). A wholly-owned subsidiary of HCP, Hanover Capital Mortgage Corporation ("HCMC"), is a servicer of multifamily mortgage loans. HCMC is approved by the U.S. Department of Housing and Urban Development (HUD) as a Title II Nonsupervised Mortgagee under the National Housing Act. Another wholly-owned subsidiary of HCP, Hanover Capital Securities, Inc. ("HCS"), is a registered broker/dealer with the Securities and Exchange Commission.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

PRINCIPLES OF CONSOLIDATION - The consolidated financial statements include the accounts of HCP and its wholly-owned subsidiaries (the "Company"). The wholly-owned subsidiaries include HCMC and HCS. All significant intercompany accounts and transactions have been eliminated.

USE OF ESTIMATES - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates, by their nature, are based on judgment and available information. Actual results could differ from the estimates.

CASH AND CASH EQUIVALENTS - Cash and cash equivalents include cash on hand, overnight investments deposited with banks and money market mutual funds primarily invested in government securities with weighted maturities less than 60 days.

PROPERTY AND EQUIPMENT - Property and equipment is stated at cost less accumulated depreciation. Depreciation is computed on the straight-line method over the estimated useful lives of the assets, generally three years.

MORTGAGE LOANS HELD FOR SALE - All mortgage loans designated as held for sale are reported in the aggregate at the lower of cost or market, with unrealized losses reported as a charge to earnings in the current period.

DEFERRED REVENUE - Cash advances received for certain service contracts are recorded in the accompanying Consolidated Balance Sheets as deferred revenue and are recognized during the period the services are provided and the related revenue is earned.

REVENUE RECOGNITION - Revenues from due diligence contracts in progress and assignment preparation services are recognized for the services provided as they are earned and billed.

INCOME TAXES - The Company files a consolidated Federal income tax return. The Company has not been subject to an examination of its income tax returns by the Internal Revenue Service. The Company's tax sharing policy provides that each member of the Federal consolidated group receive an allocation of income taxes as if each member filed a separate Federal income tax return. HCP, HCMC and HCS generally file their state income tax returns on a separate company basis.
Deferred income taxes

are provided for the effect of temporary differences between the tax basis of an asset or liability and its reported amount in the consolidated financial statements.

BASIC EARNINGS PER SHARE - Basic earnings per share is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding during the period. Shares issued during the period and shares reacquired during the period are weighted for the portion of time they were outstanding.

ESTIMATED FAIR VALUE OF FINANCIAL INSTRUMENTS - The fair value of cash and cash equivalents, accounts receivable, accounts payable and accrued expenses, due to and from related parties, and note payable to related party were determined to be their carrying value due to their short-term nature. The fair value of mortgage loans held for sale is included in Note 4 to the Consolidated Financial Statements.

RECLASSIFICATION - Certain reclassifications of prior years' amounts have been made to conform to the current year presentation.

COMPREHENSIVE INCOME - Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities, are reported as a separate component of the equity section of the Consolidated Balance Sheets, such items, along with net income, are components of comprehensive income.

RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS - On January 1, 2002, the Company adopted Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets ("SFAS 144"). SFAS 144 supersedes Statement No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of ("SFAS 121"). SFAS 144 retains the requirements of SFAS 121 for recognizing and measuring the impairment loss of long-lived assets to be held and used. For long-lived assets to be disposed of by sale, SFAS 144 requires a single accounting model be used for all long-lived assets, whether previously held and used or newly acquired. The adoption of SFAS 144 did not have an impact on the Company's consolidated financial position or results of operations.

In April 2002, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 145, Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections ("SFAS 145"). SFAS 145 rescinds FASB Statement No. 4, Reporting Gains and Losses from Extinguishment of Debt, and an amendment of that Statement, FASB Statement No. 64, Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements. SFAS 145 also rescinds FASB Statement No. 44, Accounting for Intangible Assets of Motor Carriers. SFAS 145 amends FASB Statement No. 13, Accounting for Leases, to eliminate an inconsistency between the required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. The provisions of SFAS 145 related to the rescission of FASB Statement No. 4 are generally effective for fiscal years beginning after May 15, 2002. The adoption of SFAS 145 did not have a material effect on the Company's consolidated financial statements.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS - In July 2002, the FASB issued Statement of Financial Accounting Standards No. 146, Accounting for Costs Associated with Exit or Disposal Activities ("SFAS 146"). SFAS 146 requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan.

SFAS 146 is to be applied prospectively to exit or disposal activities initiated after December 31, 2002. The adoption of SFAS 146 will not have a material effect on the Company's consolidated financial statements.

3. PROPERTY AND EQUIPMENT

	DECEMBER 31,	
	2002	2001
Office machinery and computer equipment	\$ 411,649	\$ 367,430
Furniture and fixtures	12,197	7,104
	423,846	374,534
Less accumulated depreciation	(331,915)	(273,950)
Property and equipment - net	\$ 91,931	\$ 100,584

Depreciation expense for the years ended December 31, 2002, 2001 and 2000 was \$57,965, \$53,875 and \$42,798, respectively.

4. MORTGAGE LOANS HELD FOR SALE

During the year ended December 31, 2002, the Company purchased \$208,274 of mortgage loans from Hanover Capital Mortgage Holdings, Inc. ("HCHI"). At December 31, 2002, the balance of mortgage loans held for sale was \$207,151, comprised of \$183,767 of adjustable-rate loans and \$23,384 of fixed-rate loans. The fair value of mortgage loans held for sale at December 31, 2002 was \$207,151 based upon projected prices which could be obtained through investors considering interest rates, loan type and credit quality.

5. CONCENTRATION RISK

As of and for the year ended December 31, 2002, the Company's accounts receivable and revenues included customers that individually accounted for more than 10% as follows:

ACCOUNTS RECEIVABLE AS OF DECEMBER 31, 2002		REVENUES FOR THE YEAR ENDED DECEMBER 31, 2002	
Major Customer # 1	22%	Major Customer # 1	22%
Major Customer # 2	12%	Major Customer # 2	16%
Major Customer # 3	12%	Major Customer # 3	11%
Major Customer # 4	11%		

6. MORTGAGE SERVICING

The Company, through its wholly-owned subsidiary, HCMC, services multifamily mortgage loans on behalf of others. Loan servicing consists of the collection of monthly mortgage payments on behalf of investors, reporting information to those investors on a monthly basis, and maintaining custodial escrow accounts for the payment of principal and interest to investors and property taxes and insurance premiums on behalf of borrowers. As of December 31, 2002 and 2001, HCMC was servicing 1 and 3 loans, respectively, with unpaid principal balances of \$1,099,595 and \$4,918,187, respectively including loans subserviced for others of \$3,774,586 at December 31, 2001. Escrow balances maintained by HCMC were \$65,282 and \$152,226 at December 31, 2002 and 2001, respectively. The aforementioned servicing portfolio and related escrow accounts are not included in the accompanying Consolidated Balance Sheets as of December 31, 2002, and 2001.

7. RELATED PARTY TRANSACTIONS

	DECEMBER 31,	
	2002	2001
Due from HanoverTrade, Inc. (1)	\$268,703	\$465,987
Due from Hanover Mortgage Capital Corporation	--	6,662
Due from HDMF-I LLC (2)	94,984	988
Receivables from related parties	\$363,687	\$473,637

(1) Amounts due reflect certain costs that the Company paid on behalf of HanoverTrade, Inc. The expenses billed include personnel, occupancy, travel and entertainment and general and administrative.

(2) Amount due at December 31, 2002 reflects asset management and due diligence services provided to HDMF-I.

Due to related parties of \$14,841 and \$411,232 at December 31, 2002 and 2001, respectively, are due to HCHI and primarily represent an allocation of payroll expenses and tax payments made by HCHI on behalf of HCP, partially offset by management fees charged by HCP to HCHI. The Company provides among other services, due diligence, asset management and administrative services to HCHI pursuant to a Management Agreement that continues until December 31, 2003 with automatic annual renewal.

At December 31, 2002 and 2001, the Company had a principal balance outstanding on a note payable to HCHI in the amount of \$870,298 and \$1,035,859, respectively. The note bears interest at the prime rate minus 1% and interest is calculated on the daily principal balance outstanding. At December 31, 2002 and 2001, the interest rate in effect was 3.25% and 3.75%, respectively. Included in the 2002 and 2001 Consolidated Statements of Income is interest expense in the amount of \$39,454 and \$65,555, respectively, related to this note payable. The entire unpaid principal balance on the note is due in full on the extended maturity date, March 31, 2004.

8. INCOME TAXES

The components of deferred income taxes as of December 31, 2002 and 2001 are as follows:

	DECEMBER 31,	
	2002	2001
Deferred tax assets		
Temporary differences	\$ 40,240	\$ 64,585
Federal net operating loss carryforward	140,045	318,254
State/Local net operating loss carryforward	66,211	106,085
AMT Credit	16,830	16,830
Total deferred tax assets	263,326	505,754
Valuation allowance	(23,648)	(211,713)
Net deferred tax assets	\$ 239,678	\$ 294,041

The items resulting in significant temporary differences for the years ended December 31, 2002 and 2001 that generate deferred tax assets relate primarily to the recognition of expense for financial reporting purposes. The net change of \$188,065 in the valuation allowance is due to a change in management's judgment about the realizability of the related deferred tax asset in future years.

The components of the income tax provision for the years ended December 31, 2002, 2001 and 2000 consist of the following:

	YEARS ENDED DECEMBER 31,		
	2002	2001	2000
Current - Federal, state and local	\$44,118	\$17,459	\$ 19,040
Deferred - Federal, state and local	54,363	46,690	612,682
Total	\$98,481	\$64,149	\$631,722

The income tax provision differs from amounts computed at statutory rates, as follows:

	YEARS ENDED DECEMBER 31,		
	2002	2001	2000
Federal income tax provision at statutory rate	\$ 236,535	\$32,448	\$ 374,021
State and local income tax provision	41,324	10,816	72,052
Meals and entertainment	2,313	1,812	4,065
Officer's life insurance	1,870	3,551	268
Tax settlement	2,662	15,522	--
Penalties	162	--	1,702
Realized loss on hedge transaction	--	--	(14,089)
Sale of assets	--	--	(18,010)
(Reversal of) provision for valuation allowance	(188,065)	--	211,713
Other	1,680	--	--
Total	\$ 98,481	\$64,149	\$ 631,722

The Company has a Federal tax net operating loss carryforward of approximately \$0.4 million which begins to expire in the year 2012.

9. STOCKHOLDER'S EQUITY

Prior to July 1, 2002, HCHI owned all of the outstanding preferred stock of the Company, giving it a 97% economic interest. The remaining 3% economic interest represented by all of the common stock of the Company was owned by the principals, John A. Burchett, Joyce S. Mizerak, George J. Ostendorf and Irma N. Tavares. Pursuant to a Stock Purchase Agreement effective July 1, 2002, HCHI acquired 100% of the outstanding common stock of the Company. Therefore, as of July 1, 2002, HCHI owns 100% of the outstanding capital stock, both preferred and common, of the Company.

10. COMMITMENTS AND CONTINGENCIES

The Company has noncancelable operating lease agreements for office space. Future minimum rental payments for such leases are as follows:

YEAR	AMOUNT
2003	\$ 160,932
2004	160,932
2005	53,644
	\$ 375,508

Rent expense for the years ended December 31, 2002, 2001 and 2000 amounted to \$144,610, \$128,345 and \$144,731, respectively.

11. SUBSEQUENT EVENTS

On February 21, 2003, the maturity date of the note payable to HCHI was extended from March 31, 2003 to March 31, 2004.

INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
HanoverTrade, Inc. and Subsidiary
Edison, New Jersey

We have audited the accompanying consolidated balance sheets of HanoverTrade, Inc. and Subsidiary (the "Company") as of December 31, 2002 and 2001, and the related consolidated statements of operations, stockholder's equity, and cash flows for each of the three years in the period ended December 31, 2002. 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 auditing standards generally accepted in the United States of America. 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, such consolidated financial statements present fairly, in all material respects, the financial position of HanoverTrade, Inc. and Subsidiary at December 31, 2002 and 2001, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America.

DELOITTE & TOUCHE LLP
Parsippany, New Jersey
March 20, 2003

HANOVERTRADE, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS

	DECEMBER 31,	
ASSETS	2002	2001
	-----	-----
CURRENT ASSETS:		
Cash and cash equivalents	\$ 160,219	\$ 196,451
Accounts receivable	298,258	590,234
Current portion of long-term note receivable	75,000	--
Prepaid expenses and other current assets	50,899	31,105
	-----	-----
Total current assets	584,376	817,790
PROPERTY AND EQUIPMENT - Net	157,426	176,728
CAPITALIZED SOFTWARE - Net	1,794,694	2,170,323
GOODWILL - Net	1,514,736	1,044,266
DEFERRED TAX ASSET - Net	--	--
LONG-TERM NOTE RECEIVABLE - Net of current portion	225,000	--
OTHER ASSETS	68,971	68,971
	-----	-----
TOTAL ASSETS	\$ 4,345,203	\$ 4,278,078
	=====	=====
LIABILITIES AND STOCKHOLDER'S EQUITY		
CURRENT LIABILITIES:		
Accounts payable and accrued expenses	\$ 538,970	\$ 407,372
Accrued interest due to related party	58,453	103,738
Payable under asset purchase agreement	500,000	500,000
Due to related parties	442,495	544,639
Deferred revenue	91,869	--
Other current liabilities	6,998	5,110
	-----	-----
Total current liabilities	1,638,785	1,560,859
NOTE PAYABLE TO RELATED PARTY	7,395,896	7,654,396
	-----	-----
TOTAL LIABILITIES	9,034,681	9,215,255
	-----	-----
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDER'S EQUITY:		
Series A preferred stock: \$.01 par value, 100,000 shares authorized, 97,000 shares outstanding at December 31, 2002 and 2001	970	970
Common stock: \$.01 par value, 105,000 shares authorized, 3,000 shares outstanding at December 31, 2002 and 2001	30	30
Additional paid-in capital	485,021	--
Retained earnings (deficit)	(5,175,499)	(4,938,177)
	-----	-----
TOTAL STOCKHOLDER'S EQUITY (DEFICIT)	(4,689,478)	(4,937,177)
	-----	-----
TOTAL LIABILITIES AND STOCKHOLDER'S EQUITY	\$ 4,345,203	\$ 4,278,078
	=====	=====

See notes to consolidated financial statements

HANOVERTRADE, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF OPERATIONS

	YEARS ENDED DECEMBER 31,		
	2002	2001	2000
REVENUES:			
Loan brokering, trading and advisory services	\$ 6,836,352	\$ 3,521,338	\$ 140,781
Consulting	693,210	--	--
Other	59,085	77,334	--
Total revenues	7,588,647	3,598,672	140,781
EXPENSES:			
Personnel	4,199,193	3,616,575	789,646
Depreciation and amortization	1,219,174	1,102,073	150,935
General and administrative	675,214	410,036	93,471
Technology	659,409	663,955	230,520
Occupancy	413,995	325,960	130,278
Interest	266,657	366,243	81,479
Travel and entertainment	254,024	262,695	174,821
Professional	130,305	214,669	32,143
Total expenses	7,817,971	6,962,206	1,683,293
LOSS BEFORE INCOME TAX PROVISION	(229,324)	(3,363,534)	(1,542,512)
INCOME TAX PROVISION	7,998	--	--
NET LOSS	\$ (237,322)	\$ (3,363,534)	\$ (1,542,512)
BASIC LOSS PER SHARE (NOTE 2)	\$ (79.11)	\$ (1,121.18)	\$ (514.17)

See notes to consolidated financial statements

HANOVERTRADE, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF STOCKHOLDER'S EQUITY
YEARS ENDED DECEMBER 31, 2002, 2001 AND 2000

	SERIES A PREFERRED STOCK		COMMON STOCK		ADDITIONAL PAID-IN CAPITAL
	SHARES	AMOUNT	SHARES	AMOUNT	
BALANCE, DECEMBER 31, 1999	97,000	\$ 970	3,000	\$ 30	\$ --
Comprehensive loss:					
Net loss					
Comprehensive loss					
BALANCE, DECEMBER 31, 2000	97,000	970	3,000	30	--
Comprehensive loss:					
Net loss					
Comprehensive loss					
BALANCE, DECEMBER 31, 2001	97,000	970	3,000	30	--
Capital contribution					485,021
Comprehensive loss:					
Net loss					
Comprehensive loss					
BALANCE, DECEMBER 31, 2002	97,000	\$ 970	3,000	\$ 30	\$485,021

	COMPREHENSIVE LOSS	RETAINED EARNINGS (DEFICIT)	ACCUMULATED OTHER COMPREHENSIVE GAIN	TOTAL
BALANCE, DECEMBER 31, 1999		\$ (32,131)	\$ --	\$ (31,131)
Comprehensive loss:				
Net loss	\$(1,542,512)	(1,542,512)		(1,542,512)
Comprehensive loss	\$(1,542,512)			
BALANCE, DECEMBER 31, 2000		(1,574,643)	--	(1,573,643)
Comprehensive loss:				
Net loss	\$(3,363,534)	(3,363,534)		(3,363,534)
Comprehensive loss	\$(3,363,534)			
BALANCE, DECEMBER 31, 2001		(4,938,177)	--	(4,937,177)
Capital contribution				485,021
Comprehensive loss:				
Net loss	\$ (237,322)	(237,322)		(237,322)
Comprehensive loss	\$ (237,322)			
BALANCE, DECEMBER 31, 2002		\$(5,175,499)	\$ --	\$(4,689,478)

See notes to consolidated financial statements

HANOVERTRADE, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS

	YEARS ENDED DECEMBER 31,		
	2002	2001	2000
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net loss	\$ (237,322)	\$(3,363,534)	\$(1,542,512)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:			
Depreciation and amortization	1,219,174	1,102,073	150,935
Changes in assets - (increase) decrease:			
Accounts receivable	291,976	(580,234)	(9,974)
Note receivable	(300,000)	--	--
Prepaid expenses and other assets	(19,794)	(85,201)	--
Changes in liabilities - increase (decrease):			
Accounts payable and accrued expenses	131,598	(601,031)	1,008,403
Accrued interest due to related party	(45,285)	67,874	35,864
Due to related parties	(102,144)	154,501	254,512
Deferred revenue	91,869	--	--
Other current liabilities	1,888	5,110	--
Net cash provided by (used in) operating activities	1,031,960	(3,300,442)	(102,772)
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchases of property and equipment	(86,193)	(28,620)	(21,695)
Capitalized software costs	(738,050)	(424,287)	(2,747,647)
Acquisition, net of cash acquired	--	(833,411)	--
Net cash used in investing activities	(824,243)	(1,286,318)	(2,769,342)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net (repayment of) proceeds from note payable to related party	(258,500)	4,750,638	2,903,758
Capital contributions	14,551	--	--
Net cash (used in) provided by financing activities	(243,949)	4,750,638	2,903,758
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(36,232)	163,878	31,644
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	196,451	32,573	929
CASH AND CASH EQUIVALENTS, END OF YEAR	\$ 160,219	\$ 196,451	\$ 32,573

See notes to consolidated financial statements

HANOVERTRADE, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2002, 2001 AND 2000

1. BUSINESS DESCRIPTION

HanoverTrade, Inc. and Subsidiary is principally engaged in operating an Internet exchange for trading mortgage loans, mortgage servicing rights and related assets, and providing state-of-the-art technologies supported by experienced valuation, operations and trading professionals. In addition to trading assets, HanoverTrade, Inc. and Subsidiary provides a full range of asset valuation, analysis, and marketing services for performing, sub-performing and non-performing assets, whole loans and participations, Community Reinvestment Act loans, and mortgage servicing rights. During 2002, Pamex Securities, LLC, a wholly-owned subsidiary of HanoverTrade, Inc., withdrew from the National Association of Securities Dealers as a registered broker/dealer.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

PRINCIPLES OF CONSOLIDATION - The consolidated financial statements include the accounts of HanoverTrade, Inc. and its wholly-owned subsidiary (the "Company"). All significant intercompany accounts and transactions have been eliminated.

USE OF ESTIMATES; RISKS AND UNCERTAINTIES - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates, by their nature, are based on judgment and available information. Actual results could differ from the estimates. The Company's estimates and assumptions primarily arise from risks and uncertainties associated with technology. Although management is not currently aware of any factors that would significantly change its estimates and assumptions in the near term, it is possible that the estimated useful lives of the Company's technology assets and related carrying values could be reduced in the near term due to competitive pressures.

CASH AND CASH EQUIVALENTS - Cash and cash equivalents include cash on hand, overnight investments deposited with banks and money market mutual funds primarily invested in government securities with weighted maturities less than 60 days.

PROPERTY AND EQUIPMENT - Property and equipment is stated at cost less accumulated depreciation. Depreciation is computed on the straight-line method over the estimated useful lives of the assets, generally three years. Leasehold improvements are amortized over the terms of the respective leases or their estimated useful lives, whichever is shorter.

CAPITALIZED SOFTWARE - Capitalized software includes external application development stage costs and external enhancement costs incurred to develop and modify the Company's Internet exchange for trading loan pools and also includes software production costs incurred to develop a mortgage loan servicing valuation and analysis tool, a real-time Internet data analysis system and an Internet exchange for trading assets. Capitalized software costs for the Company's Internet exchange are stated at cost less accumulated amortization and are evaluated for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Amortization is computed on the straight-line method over the estimated useful lives of the assets, generally three years. The Company periodically reassesses the estimated useful lives of the assets considering the effects of obsolescence, technology, competition and other economic factors. Capitalized software costs for the Company's mortgage loan servicing valuation and analysis tool, real-time Internet data analysis system and Internet exchange for trading assets are stated at the lower of unamortized cost or net realizable value. Amortization is computed based on current and future revenue for each product with an annual minimum equal to the straight-line amortization over the remaining estimated economic life of the product.

GOODWILL - Goodwill represents the excess of the purchase price over the net carrying value of assets acquired (which approximates fair value) at acquisition date. The Company evaluates goodwill for impairment on an annual basis and if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount.

DEFERRED REVENUE - Certain service contracts are recorded in the accompanying Consolidated Balance Sheets as deferred revenue and are recognized during the period the services are provided and the related revenue is earned.

REVENUE RECOGNITION - Revenues from loan brokering, trading and advisory services are recognized when the transactions close and fees are earned and billed. At the time of closing a transaction, the number of loans, loan principal balance and purchase price in the transaction are agreed upon, documentation is signed and the sale is funded. The Company's billing of fees relating to a transaction occurs concurrently with the closing and funding. Revenues from consulting services are recognized as they are earned and billed.

INCOME TAXES - The Company uses the asset and liability method in accounting for income taxes. This measures the tax effect of differences between the tax basis and financial statement carrying amounts of assets and liabilities.

BASIC EARNINGS PER SHARE - Basic earnings per share is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding during the period. Shares issued during the period and shares reacquired during the period are weighted for the portion of time they were outstanding.

RELATED PARTY TRANSACTIONS - The results of operations may not necessarily be indicative of those that would have occurred on a stand-alone basis.

ESTIMATED FAIR VALUE OF FINANCIAL INSTRUMENTS - The fair values of cash and cash equivalents, accounts receivable, note receivable, accounts payable and accrued expenses, due to related parties and note payable to related party were determined to be their carrying values due to their short-term nature.

RECLASSIFICATION - Certain reclassifications of prior years' amounts have been made to conform to the current year presentation.

RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS - On January 1, 2002, the Company adopted Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets ("SFAS 144"). SFAS 144 supersedes Statement No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of ("SFAS 121"). SFAS 144 retains the requirements of SFAS 121 for recognizing and measuring the impairment loss of long-lived assets to be held and used. For long-lived assets to be disposed of by sale, SFAS 144 requires a single accounting model be used for all long-lived assets, whether previously held and used or newly acquired. The adoption of SFAS 144 did not have an impact on the Company's consolidated financial position or results of operations.

In April 2002, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 145, Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections ("SFAS 145"). SFAS 145 rescinds FASB Statement No. 4, Reporting Gains and Losses from Extinguishment of Debt, and an amendment of that Statement, FASB Statement No. 64, Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements. SFAS 145 also rescinds FASB Statement No. 44, Accounting for Intangible Assets of Motor Carriers. SFAS 145 amends FASB Statement No. 13, Accounting for Leases, to eliminate an inconsistency between the required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. The provisions of SFAS 145 related to the rescission of FASB Statement No. 4 are generally effective for fiscal years beginning after May 15, 2002. The adoption of SFAS 145 did not have a material effect on the Company's consolidated financial statements.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS - In July 2002, the FASB issued Statement of Financial Accounting Standards No. 146, Accounting for Costs Associated with Exit or Disposal Activities ("SFAS 146"). SFAS 146 requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. SFAS 146 is to be applied prospectively to exit or disposal activities initiated after December 31, 2002. The adoption of SFAS 146 will not have a material effect on the Company's consolidated financial statements.

3. ACQUISITION

On January 19, 2001, the Company hired 18 employees of Pamex Capital Partners LLC ("Pamex") and purchased all of its assets. The Company entered into employment agreements with 6 of the 18 employees hired. The purchase price consisted of \$850,000 in cash paid at closing, professional fees of \$18,530 plus an earn-out of between \$1,250,000 and \$1,500,000, payable over three years in common stock of Hanover Capital Mortgage Holdings, Inc. ("HCHI"). The acquisition was accounted for using the purchase method of accounting. As of December 31, 2002, the first earn-out of \$500,000 in common stock of HCHI has been paid and a second earn-out of \$500,000 has been accrued. The second earn-out was subsequently paid on February 24, 2003. In addition, the Company was required, under terms of the purchase agreement, to adopt an employee stock option plan pursuant to which it was to issue options to purchase 5% of the number of shares of common stock outstanding as of January 19, 2001. However, on February 25, 2003, HCHI granted options to purchase 30,000 shares of its common stock under its 1999 Equity Incentive Plan in satisfaction of the Company's obligation. The stock options were issued with an exercise price of \$7.69, were fully vested on the date of grant and expire on February 24, 2008, excluding the grantee's death or termination of employment. Included in the assets purchased was Pamex Securities, LLC, a securities broker dealer with minimal net assets and insignificant net income from continuing operations for the period from January 19, 2001 to December 31, 2001.

4. PROPERTY AND EQUIPMENT

	DECEMBER 31,	
	2002	2001
Office machinery and equipment	\$272,244	\$206,344
Furniture and fixtures	54,914	53,136
Leasehold improvements	18,985	470
	346,143	259,950
Less accumulated depreciation and amortization	(188,717)	(83,222)
Property and equipment-net	\$157,426	\$176,728

Depreciation and amortization expense for the years ended December 31, 2002, 2001 and 2000 was \$105,495, \$81,208 and \$2,014, respectively.

5. CAPITALIZED SOFTWARE

	DECEMBER 31,	
	2002	2001
Capitalized software costs	\$ 4,013,524	\$ 3,275,474
Less accumulated amortization	(2,218,830)	(1,105,151)
Capitalized software - net	\$ 1,794,694	\$ 2,170,323

Amortization expense for the years ended December 31, 2002, 2001 and 2000 was \$1,113,679, \$956,230 and \$148,921, respectively. The estimated aggregate amortization expense, as of December 31, 2002, for the years ending December 31, 2003, 2004, 2005 and 2006 is \$1,183,941, \$381,143, \$224,501 and \$5,109, respectively.

6. GOODWILL

Balance as of December 31, 2001	\$1,044,266
Adjustment	(29,530)
Addition	500,000
Balance as of December 31, 2002	\$1,514,736

On February 19, 2002, the Company received a capital contribution from HCHI of 63,577 shares of HCHI common stock with a then fair market value of \$470,470. The Company utilized the capital contribution to fund the first earn-out issued in connection with its purchase of all of the assets of Pamex. The difference between the amount accrued at December 31, 2001 and the capital contribution at February 19, 2002, or \$29,530, was reflected as an adjustment to goodwill. As of December 31, 2002, a second earn-out of \$500,000 has been accrued.

No impairment losses were recognized for the year ended December 31, 2002.

7. NOTE RECEIVABLE

On November 15, 2002, the Company entered into a credit and security agreement with VerticalCrossings.com, Inc. ("Vcross"). Vcross specializes in trading U.S. Treasury and Agency securities and structured products. Pursuant to this agreement, the Company loaned Vcross \$300,000 at an interest rate of 12%. Interest is payable monthly and principal is payable in four equal quarterly payments beginning on December 1, 2003. The loan is collateralized by all of Vcross' assets. As additional consideration for the loan, the Company received an exclusive perpetual license to use Vcross' proprietary software technology to conduct on-line auctions of mortgage loans. The Company also received warrants to purchase up to 33,469 shares of Vcross common stock. From previous transactions with Vcross, the Company has warrants to purchase up to an additional 15,646 shares of Vcross common stock. These warrants are not actively traded and at December 31, 2002, the Company has valued them at zero in the accompanying Consolidated Balance Sheet.

8. CONCENTRATION RISK

As of and for the year ended December 31, 2002, two of the Company's customers individually accounted for 66% and 24% of accounts receivable and one customer accounted for 49% of total revenues. No other customer individually accounted for more than 10% of accounts receivable or total revenues.

9. RELATED PARTY TRANSACTIONS

	DECEMBER 31,	
	2002	2001
	-----	-----
Due to Hanover Capital Partners Ltd.	\$ 270,987	\$ 466,287
Due to Hanover Capital Mortgage Holdings, Inc.	172,871	78,400
Other	(1,363)	(48)
	-----	-----
Due to related parties	\$ 442,495	\$ 544,639
	=====	=====

For the years ended December 31, 2002, 2001 and 2000, Hanover Capital Partners Ltd. ("HCP") and HCHI billed certain expenses to the Company. The expenses billed include personnel, travel and entertainment, general and administrative, occupancy, technology and professional. These expenses were billed to reflect certain costs paid on behalf of the Company. The Company expects similar billings from HCP and HCHI in future periods.

HCP billed the following expenses to the Company for the years ended December 31, 2002, 2001 and 2000:

	YEARS ENDED DECEMBER 31,		
	2002	2001	2000
	-----	-----	-----
Personnel	\$2,652,028	\$2,504,855	\$441,214
Travel and entertainment	140,427	150,157	57,320
General and administrative	28,764	23,215	47,299
Occupancy	7,123	20,086	25,466
Technology	4,705	10,415	3,600
Professional	--	1,961	--
	-----	-----	-----
	\$2,833,047	\$2,710,689	\$574,899
	=====	=====	=====

The above expenses were partially offset by revenues billed by the Company to HCP of \$110,962 for the year ended December 31, 2000.

HCHI billed the following expenses to the Company for the years ended December 31, 2002, 2001 and 2000:

	YEARS ENDED DECEMBER 31,		
	2002	2001	2000
Personnel	\$561,419	\$353,993	\$369,047
Occupancy	--	19,957	102,840
General and administrative	4,750	2,051	16,118
	\$566,169	\$376,001	\$488,005
	=====	=====	=====

At December 31, 2002 and 2001, the Company had a principal balance on a note payable to HCHI in the amount of \$7,395,896 and \$7,654,396, respectively. The maximum loan amount under this note is \$10 million. The note bears interest daily at the prime rate minus 1% and interest is calculated on the daily principal balance outstanding. At December 31, 2002 and 2001, the interest rate in effect was 3.25% and 3.75%, respectively. The entire unpaid principal balance on the note is due in full on the extended maturity date, March 31, 2004.

10. INCOME TAXES

	DECEMBER 31,	
	2002	2001
Deferred tax assets - Federal	\$ 1,763,975	\$ 1,660,082
Deferred tax assets - State	268,063	284,207
	2,032,038	1,944,289
Valuation allowance	(2,032,038)	(1,944,289)
Deferred tax asset - net	\$ --	\$ --
	=====	=====

The items resulting in significant temporary differences for the years ended December 31, 2002 and 2001 that generate deferred tax assets relate primarily to the benefit of net operating loss carryforwards and goodwill amortization. The Company has established a valuation allowance for the full amount of the deferred income tax benefit.

The components of the income tax provision for the years ended December 31, 2002, 2001 and 2000 consist of the following:

	YEARS ENDED DECEMBER 31,		
	2002	2001	2000
Current - Federal, state and local	\$ 7,998	\$ --	\$ --
Deferred - Federal, state and local	(87,749)	(1,323,465)	(608,395)
	(79,751)	(1,323,465)	(608,395)
Valuation allowance	87,749	1,323,465	608,395
Total	\$ 7,998	\$ --	\$ --
	=====	=====	=====

The income tax provision differs from amounts computed at statutory rates, as follows:

	YEARS ENDED DECEMBER 31,		
	2002	2001	2000
Federal income tax benefit at statutory rate	\$ (77,970)	\$(1,143,602)	\$(524,454)
State and local income tax benefit	(12,324)	(191,274)	(97,050)
Meals and entertainment	7,145	8,609	11,228
Officers' life insurance	3,391	2,802	1,881
Tax amortization in excess of book amortization	(38,837)	--	--
Effect of rate changes on prior year deferred tax assets	32,331	--	--
State alternative minimum tax	7,998	--	--
Other	(1,485)	--	--
	(79,751)	(1,323,465)	(608,395)
Valuation allowance	87,749	1,323,465	608,395
Income tax provision	\$ 7,998	\$ --	\$ --

The Company has a Federal tax net operating loss carryforward of approximately \$5,162,000 that begins to expire in 2019.

11. STOCKHOLDER'S EQUITY

Prior to July 1, 2002, HCHI owned all of the outstanding preferred stock of the Company, giving it a 97% economic interest. The remaining 3% economic interest represented by all of the common stock of the Company was owned by the principals, John A. Burchett, Joyce S. Mizerak, George J. Ostendorf and Irma N. Tavares. Pursuant to a Stock Purchase Agreement effective July 1, 2002, HCHI acquired 100% of the outstanding common stock of the Company. Therefore, as of July 1, 2002, HCHI owns 100% of the outstanding capital stock, both preferred and common, of the Company.

On February 19, 2002, the Company received a capital contribution from HCHI of 63,577 shares of HCHI common stock with a then fair market value of \$470,470. The Company utilized the capital contribution to fund the first earn-out issued in connection with its purchase of all of the assets of Pamex. The difference between the amount accrued at December 31, 2001 and the capital contribution at February 19, 2002, or \$29,530, was reflected as an adjustment to goodwill. In addition, on February 19, 2002, the Company received a capital contribution from the principals of \$14,551 to maintain the principals' 3% economic interest in the Company.

12. COMMITMENTS AND CONTINGENCIES

The Company has noncancelable operating lease agreements for office space. Future minimum rental payments for such leases are as follows:

YEAR	AMOUNT
2003	\$ 201,316
2004	141,039
2005	45,933
	\$ 388,288

Rent expense for the years ended December 31, 2002, 2001 and 2000 amounted to \$199,101, \$190,379 and \$69,533, respectively.

13. SUPPLEMENTAL DISCLOSURES FOR STATEMENTS OF CASH FLOWS

	YEARS ENDED DECEMBER 31,		
	2002	2001	2000
SUPPLEMENTAL CASH FLOW INFORMATION:			
Cash paid during the year for:			
Income taxes	\$ 1,000	\$ --	\$ --
	=====	=====	=====
Interest to related party	\$ 311,942	\$ 298,369	\$45,615
	=====	=====	=====
ACQUISITION, NET OF CASH ACQUIRED:			
Fair value of assets acquired	\$ --	\$ 259,629	\$ --
Goodwill at acquisition	--	590,371	--
Direct costs of acquisition	--	18,530	--
Less cash acquired	--	(35,119)	--
	-----	-----	-----
Net cash paid for acquisition	\$ --	\$ 833,411	\$ --
	=====	=====	=====
SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING ACTIVITIES:			
First and second earn-outs accrued in connection with the acquisition of all of the assets of Pamex resulting in increases in goodwill and payable under asset purchase agreement	\$ 500,000	\$ 500,000	\$ --
	=====	=====	=====
Capital contribution received of 63,577 shares of HCHI common stock utilized to fund the first earn-out in connection with the acquisition of all of the assets of Pamex	\$ 470,470	\$ --	\$ --
	=====	=====	=====

14. SUBSEQUENT EVENTS

On February 21, 2003, the maturity date of the note payable to HCHI was extended from March 31, 2003 to March 31, 2004.

On February 24, 2003, the Company received a capital contribution from HCHI of \$75,000 of cash and 60,180 shares of HCHI common stock with a then fair market value of \$457,970. The capital contribution was utilized by the Company to fund the second earn-out issued in connection with its purchase of all of the assets of Pamex. The difference between the amount accrued at December 31, 2002 and the capital contribution on February 24, 2003, or \$32,970, will be reflected as an adjustment to goodwill.

STOCK PURCHASE AGREEMENT

THIS STOCK PURCHASE AGREEMENT (this "Agreement") dated as of December 13, 2002, is made and entered into by and between Thomas P. Kaplan (the "Seller") and Hanover Capital Mortgage Holdings, Inc., a Maryland corporation (the "Corporation").

WHEREAS, the Seller owns directly, beneficially and of record, 80,794 shares of the Corporation's common stock, par value \$0.01 per share ("Common Stock"); and

WHEREAS, the Seller desires to sell, and the Corporation desires to purchase, 34,975 shares of Common Stock (the "Shares"), on the terms and conditions set forth herein.

NOW, THEREFORE, in consideration of the foregoing and of the agreements, covenants, and representations hereinafter contained, the Seller and the Corporation, intending to be legally bound, hereby agree as follows:

1. SALE AND PURCHASE OF THE SHARES.

1.1 Agreement to Sell. Upon the terms and conditions set forth herein, the Seller shall sell, assign, transfer and deliver the Shares free and clear of all liens, claims, charges, pledges, security interests, pre-emptive rights, rights of first refusal, obligations, encumbrances and restrictions (collectively, "Liens"), to the Corporation at the Closing (as defined in Section 1.3), and the Corporation shall purchase and accept the Shares from the Seller at the Closing.

1.2 Purchase Price. In consideration of the sale, assignment, transfer and delivery of the Shares to the Corporation by the Seller, and in reliance on the representations and covenants hereinafter set forth, the aggregate purchase price for the Shares shall be \$241,803.20 (the "Purchase Price"). In lieu of receiving any part of the Purchase Price in cash or otherwise, Seller hereby directs, instructs and authorizes the Corporation to apply the Purchase Price to satisfy in full the principal and interest accrued under that certain Promissory Note issued by the Seller to the Corporation on September 15, 1999, which principal and interest total \$247,579 on the date hereof (the "Note"). In the event the Purchase Price exceeds the amount required to satisfy Seller's obligation to the Corporation under the Note in full, then the Corporation shall pay the Seller the excess amount in cash by check.

1.3 Closing. Subject to the terms and conditions of this Agreement, the sale and purchase of the Shares contemplated hereby (the "Closing") shall take place on December 13, 2002 by exchange of this Agreement and all other deliveries contemplated hereby executed by the parties, via facsimile followed by delivery of such executed documents via overnight delivery, provided that the Closing may take place by such other means or at such other time, date or place as may be mutually agreed upon by the parties to this Agreement in writing.

1.4 The Seller's Obligations at Closing. At the Closing, Seller will deliver to the Corporation the following:

(a) certificate(s) representing the Shares (the "Certificates"), accompanied by a Stock Power duly executed in blank and in substantially the form attached hereto as Exhibit A; and

(b) such other documents and instruments as may be required to consummate the transactions contemplated hereby.

1.5 Corporation's Obligations at Closing. At the Closing, the Corporation will:

(a) apply the Purchase Price as directed in Section 1.2 hereof; and

(b) deliver to the Seller such documents and instruments as may be required to consummate the transactions contemplated hereby.

2. REPRESENTATIONS AND WARRANTIES OF THE SELLER. The Seller represents and warrants to the Corporation that the statements contained in this Section 2 are true and correct as of the date of this Agreement and will be true and correct as of the Closing:

2.1 Title to the Shares. The Seller is the sole beneficial and record owner of the Shares, and owns such Shares free and clear of any Liens (other than any Liens of the Corporation in connection with the Note) and has and at Closing will have full power and authority to convey such Shares free and clear of any Liens, and upon delivery of payment for the Shares as herein provided, the Seller will convey to the Corporation good title thereto free and clear of any Liens.

2.2 Capacity; Authority; Binding Effect. The Seller has the legal capacity to execute, deliver and perform this Agreement and each other document being executed in connection herewith to which he is a party. This Agreement has been duly and validly executed and delivered by the Seller and (assuming the due authorization, execution and delivery thereof by the Corporation) constitutes the legal, valid and binding obligation of the Seller, enforceable against him in accordance with its terms, except to the extent that enforceability may be limited by applicable bankruptcy, insolvency, reorganization, moratorium or similar laws affecting the enforcement of creditors rights and remedies generally and subject to general principles of equity.

2.3 No Conflict. The execution, delivery and performance of this Agreement by the Seller do not and will not (a) violate or conflict with any law, ordinance, regulation, rule, code, order, judgment or decree applicable to the Seller, the Shares, or this Agreement; or (b) result in any breach of, or constitute a default (or event that, with the giving of notice or lapse of time, or both, would become a default) under, or give to others any rights of termination, amendment, acceleration or cancellation of, or result in the creation of any encumbrance on any of the Shares pursuant to, any contract to which the Seller is a party or by which the Shares are bound.

2.4 Brokers and Advisors. The Seller has not taken any action which would give rise to a valid claim against any party hereto for a brokerage commission, finder's fee or like payment.

3. REPRESENTATIONS AND WARRANTIES OF THE CORPORATION. The Corporation hereby represents and warrants to Seller that the statements contained in this Section 3 are true and correct as of the date of this Agreement and will be true and correct as of the Closing:

3.1 Organization. The Corporation is a corporation validly existing under the laws of the state of Maryland.

3.2 Authority; Binding Effect. The Corporation has been duly authorized to execute and deliver this Agreement and each other document being executed in connection herewith to which the Corporation is a party. This Agreement has been duly and validly executed and delivered by the Corporation and (assuming the due authorization, execution and delivery thereof by the Seller) constitutes the legal, valid and binding obligation of the Corporation, enforceable against the Corporation in accordance with its terms, except to the extent that enforceability may be limited by applicable bankruptcy, insolvency, reorganization, moratorium or similar laws affecting the enforcement of creditors rights and remedies generally and subject to general principles of equity.

3.3 Brokers and Advisors. The Corporation has not taken any action which would give rise to a valid claim against any party hereto for a brokerage commission, finder's fee or like payment.

4. COVENANTS OF CORPORATION. The Corporation covenants to the Seller that, except as otherwise consented to in writing by the Seller, from and after the date of this Agreement, the Corporation will use its best efforts to cause all of the conditions described in Sections 7.1 and 7.2 of this Agreement to be satisfied. In the event the Certificates represent shares of Common Stock in excess of the Shares to be sold hereunder (such number of shares of Common Stock in excess of the Shares, the "Excess Shares"), then the Corporation will use its best efforts to provide to EquiServe, as transfer agent for the Corporation (the "Transfer Agent") the documents reasonably needed by the Transfer Agent, and to otherwise cooperate with the Seller and the Transfer Agent, in order for the Transfer Agent to issue certificate(s) representing the Excess Shares to Seller, and to issue certificate(s) representing the Shares to the Corporation, as soon after Closing as practicable.

5. COVENANTS OF THE SELLER. Seller covenants to the Corporation that, except as otherwise consented to in writing by the Corporation, from and after the date of this Agreement, Seller will use his best efforts to cause all of the conditions described in Sections 6.1 and 6.2 of this Agreement to be satisfied. In the event the Certificates include Excess Shares, Seller will use his best efforts to provide to the Transfer Agent the documents reasonably needed by the Transfer Agent, and to otherwise cooperate with the Corporation and the Transfer Agent, in order for the Transfer Agent to issue certificate(s) representing the Shares to the Corporation,

and to issue certificate(s) representing the Excess Shares to Seller, as soon after Closing as practicable.

6. CONDITIONS TO THE CORPORATION'S OBLIGATIONS. Unless waived by the Corporation in writing in its sole discretion, all obligations of the Corporation under this Agreement are subject to the fulfillment, prior to or at the Closing, of each of the following conditions:

6.1 Representations, Warranties and Covenants of the Seller. The representations and warranties of the Seller contained in Section 2 of this Agreement shall be true and correct at and as of the Closing with the same effect as though such representations and warranties had been made at and as of such time; Seller shall have performed all obligations and complied with all covenants required by this Agreement to be performed or complied with by him prior to the Closing.

6.2 Closing Deliveries of the Seller. Seller shall have made the Closing deliveries required pursuant to Section 1.4.

6.3 Legal Matters. No claim, action, suit, arbitration, investigation or other legal or administrative proceeding shall have been brought or threatened which questions the validity or legality of the transactions contemplated hereby. No statute, rule, regulation, executive order, decree or order of any kind shall have been enacted, entered, promulgated or enforced which prohibits the transactions contemplated hereby.

7. CONDITIONS TO THE SELLER'S OBLIGATIONS. Unless waived by the Seller in writing, all obligations of the Seller under this Agreement are subject to the fulfillment, prior to or at the Closing, of each of the following conditions:

7.1 Representations, Warranties and Covenants. The representations and warranties of the Corporation contained in Section 3 of this Agreement shall be true and correct at and as of the Closing with the same effect as though such representations and warranties had been made at and as of such time; the Corporation shall have performed all obligations and complied with all covenants required by this Agreement to be performed or complied with by it on or prior to the Closing.

7.2 Closing Deliveries of Corporation. The Corporation shall have taken the actions required pursuant to Section 1.5.

7.3 Legal Matters. No claim, action, suit, arbitration, investigation or other legal or administrative proceeding shall have been brought or threatened which questions the validity or legality of the transactions contemplated hereby. No statute, rule, regulation, executive order, decree or order of any kind shall have been enacted, entered, promulgated or enforced which prohibits the transactions contemplated hereby.

8. INDEMNIFICATION.

8.1 Survival of Representations and Warranties. The representations, warranties, covenants and agreements of the parties hereto contained in this Agreement, shall be deemed material and shall be deemed to have been relied upon by the parties hereto. All of the representations, warranties, covenants, and agreements made by the parties hereto shall survive the execution and delivery of this Agreement and the Closing hereunder until the time on which the applicable statute of limitations has expired or indefinitely if no statute of limitation applies. There shall be no termination of any such representation or warranty as to which any actions, suit, claim, or counterclaim or legal, administrative or arbitration proceeding or investigation has been asserted prior to the termination of such survival period.

8.2 Indemnification by the Seller. Seller shall indemnify, defend, save and hold the Corporation and any of its agents, representatives, successors or assigns, harmless from and after the Closing against and in respect of any and all demands, claims, allegations, assertions, actions or causes of action, assessments, losses, damages, deficiencies, liabilities, costs and expenses (including reasonable attorneys' fees and expenses) (collectively, "Losses") asserted against, imposed upon, resulting to, required to be paid by, or incurred by the Corporation, directly or indirectly, in connection with, arising out of, which could result in, or which would not have occurred but for:

(a) any breach by him of any representation or warranty contained in this Agreement; or

(b) any breach or nonfulfillment of any covenant or agreement made by him in this Agreement.

8.3 Indemnification by Corporation. The Corporation shall indemnify, defend, save and hold Seller and any of his agents, representatives, or heirs harmless from and after the Closing against and in respect of any and all Losses asserted against, imposed upon, resulting to, required to be paid by, or incurred by Seller, directly or indirectly, in connection with, arising out of, which could result in, or which would not have occurred but for:

(a) any breach by the Corporation of any representation or warranty contained in this Agreement; or

(b) any breach or nonfulfillment of any covenant or agreement made by the Corporation in this Agreement.

8.4 Notice and Defense. If at any time the Corporation or any of its agents, representatives, successors or assigns, or Seller or any of his agents, representatives or heirs (the "Indemnified Party") believes that it has suffered or incurred, or will suffer or incur, or shall receive notice of, any asserted Losses claimed to give rise to indemnification under Section 8.2 or 8.3, the Indemnified Party shall promptly give notice thereof ("Claims Notice") to the indemnifying party (the "Indemnifying Party") of any such Losses. The Claims Notice shall set forth a brief description of the Losses, and, if known or reasonably estimable, the amount of the

Losses that have been or may be suffered by the Indemnified Party. The failure of the Indemnified Party to give any notice required by this Section 8.4 shall not affect the Indemnified Party's rights under this Section 8 or otherwise except to the extent that such failure is prejudicial to the rights or obligations of the Indemnifying Party.

8.5 Third Party Claims. If any Losses relate to any action, suit, proceeding or demand instituted against the Indemnified Party by a third party (a "Third Party Claim"), the Indemnifying Party shall be entitled to participate in the defense of any such Third Party Claim at the sole cost and expense of the Indemnifying Party through counsel chosen by the Indemnifying Party and approved by the Indemnified Party (which approval shall not be unreasonably withheld); provided, however, that any compromise or defense shall be conducted in a manner which is reasonable and not contrary to the Indemnified Party's interests and the Indemnified Party shall in all events have a right to veto any compromise or defense that is unreasonable or which would jeopardize in any material respect any assets or business of the Indemnified Party or any of its affiliates or increase the potential liability of, or create a new liability for, the Indemnified Party or any of its affiliates and, provided further that the Indemnifying Party shall in all events indemnify the Indemnified Party and its affiliates against any Losses resulting from the manner in which such Third Party Claim is compromised or defended, including any failure to pay any such claim while such litigation is pending. If the Indemnifying Party does so undertake to compromise and defend a claim, the Indemnifying Party shall notify the Indemnified Party of its intention to do so within thirty (30) days after receipt of a Claims Notice. Even if the Indemnifying Party undertakes to compromise or defend a claim, the Indemnified Party shall have the right to defend, compromise or settle any Third Party Claim for which a claim for indemnification has been made hereunder upon notice to the Indemnifying Party and by waiving any right against the Indemnifying Party with respect to such Third Party Claim. Each party agrees in all cases to cooperate with the defending party and its counsel in the compromise of or defending of any such liabilities or claims. In addition, the nondefending party shall at all times be entitled to monitor such defense through the appointment, at its own cost and expense, of advisory counsel of its own choosing.

9. MISCELLANEOUS.

9.1 Expenses. Except as otherwise set forth herein, each party to this Agreement shall pay all of its expenses relating hereto, including any income, capital gains, sales, transfer or documentary taxes, and fees and disbursements of its counsel, accountants and financial advisors, whether or not the transactions hereunder are consummated.

9.2 Notices. Except as otherwise provided herein, all notices, requests, demands and other communications under or in connection with this Agreement shall be in writing, and shall be addressed:

(a) If to the Corporation:

Hanover Capital Mortgage Holdings, Inc.
379 Thornall Street
Edison, New Jersey 08837
Attn: General Counsel
Telephone: (732) 548-0101
Telecopy: (732) 548-0286

with a copy to:

Piper Rudnick LLP
6225 Smith Avenue
Baltimore, Maryland 21209
Attn: R. W. Smith, Jr., Esq.
Telephone: (410) 580-3000
Telecopy: (410) 580-3001

(b) If to the Seller:

Thomas P. Kaplan
229 E 79th Street, Apartment #14A
New York, New York 10021

Telephone:
Telecopy:

with a copy to:

All such notices, requests, demands or communications shall be mailed postage prepaid, certified mail, return receipt requested, or by overnight delivery or delivered personally, and shall be sufficient and effective when delivered to or received at the address so specified. Any party may change the address at which it is to receive notice by like written notice to the others.

9.3 Entire Agreement. This Agreement is intended by the parties to and does constitute the entire agreement of the parties with respect to the transactions contemplated by this Agreement. This Agreement supersedes any and all prior understandings between the parties regarding the transactions contemplated herein, whether written or oral, and this Agreement may be amended, modified, waived, discharged or terminated only by an instrument in writing signed by the party against which enforcement of the amendment, modification, waiver, discharge or termination is sought. Notwithstanding any of the foregoing, nothing in this Agreement shall be deemed to modify, amend, terminate or vitiate, in any way, the terms of the Note, and Seller shall remain obligated by the terms of the Note until the Seller satisfies the Note pursuant to the terms thereof.

9.4 General. The paragraph headings contained in this Agreement are for reference purposes only and shall not affect in any way the meaning or interpretation of this Agreement. All references made and pronouns used herein shall be construed in the singular or plural, and in such gender, as the sense and circumstances require. This Agreement may be executed in two counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument. This Agreement shall be effective only upon execution by both parties hereto. This Agreement shall inure to the benefit of and be binding upon the parties hereto and their respective successors and assigns, but nothing herein, express or implied, is intended to or shall confer any rights, remedies or benefits upon any person other than the parties hereto. This Agreement may not be assigned by any party hereto, except that the Corporation may assign this Agreement to one or more of its subsidiaries or affiliates, provided that the Corporation shall remain primarily liable on this Agreement, notwithstanding any assignment. This Agreement shall be construed in accordance with and governed by the laws of the State of Maryland, without giving effect to the principles of conflicts of law thereof.

9.5 Consultation with Attorney. Seller acknowledges that he has consulted with independent legal counsel of his choosing regarding the terms of this Agreement before signing it and that in executing this Agreement he has not relied upon any representations or statements by the Corporation or any of its shareholders, agents, representatives, employees, or attorneys regarding the subject matter, basis or effect of this Agreement.

[REMAINDER OF PAGE INTENTIONALLY LEFT BLANK.]

IN WITNESS WHEREOF, the Seller and the Corporation have caused this Agreement to be duly executed as of the date first above written.

WITNESS/ATTEST:

THE SELLER:

[SEAL]

Thomas P. Kaplan

CORPORATION:
HANOVER CAPITAL MORTGAGE HOLDINGS, INC.

By:

[SEAL]

Name: John A. Burchett
Title: President and Chief Executive Officer

EXHIBIT A

FORM OF STOCK POWER

FOR VALUE RECEIVED, the undersigned does hereby sell, assign and transfer unto Hanover Capital Mortgage Holdings, Inc., a Maryland corporation (the "Corporation"), [] shares of common stock, \$0.01 par value per share, of the Corporation, standing in the name of the undersigned on the books of the Corporation, represented by Stock Certificate Number [], and the undersigned does hereby irrevocably constitute and appoint _____, as secretary to transfer the said stock on the books of the Corporation with full power of substitution.

Dated: _____

Thomas P. Kaplan

State of New Jersey)
) ss:
County of Middlesex)

Subscribed and sworn to before me, the undersigned, a Notary Public of the State of New Jersey, in and for the County of Middlesex, this 13th day of December, 2002, by Thomas P. Kaplan, known to me (or satisfactorily proven) to be the person named in the foregoing Stock Power, who made oath that the matters and facts stated therein are true and correct to the best of his or her knowledge, information, and belief.

Notary Public

My Commission expires _____

SECOND MODIFICATION AND EXTENSION OF LEASE AGREEMENT

This Second Modification and Extension of Lease Agreement ("Agreement"), made this 22 day of April, 2002, by and between Metroplex Associates, a New Jersey partnership, having an address c/o of Atlantic Realty Development Corp., 90 Woodbridge Center Drive, Woodbridge, New Jersey 07095 (the "Landlord"), and Hanover Capital Mortgage Corp., a Missouri corporation, having an address at Metroplex Corporate Center I, 100 Metroplex Drive, Edison, New Jersey 08817 (the "Tenant").

W I T N E S S E T H:

WHEREAS, by lease dated March 9, 1994 (the "Lease"), Landlord leased to Tenant and Tenant hired from Landlord certain premises (the "Premises") constituting a portion of the third floor of the building (the "Building") known as Metroplex Corporate Center I, 100 Metroplex Drive, Edison, New Jersey 08817; and

WHEREAS, by document entitled "First Modification and Extension of Lease Agreement", dated February 28, 1997 (the "First Modification"), the term of the Lease was extended until 6:00 p.m. on June 30, 2002; and

WHEREAS, Landlord and Tenant desire to further modify and extend the Lease as hereinafter provided;

NOW, THEREFORE, for and in consideration of the above premises, the mutual covenants hereinafter contained, and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, Landlord and Tenant hereby agree as follows:

1. Term. (a) Landlord and Tenant agree to extend the term of the Lease for a period of two (2) years and ten (10) months, commencing 6:00 p.m. on June 30, 2002 and expiring at 6:00 p.m. on April 30, 2005 (the "Second Renewal Period").

(b) Tenant shall have, and is hereby granted, one (1) additional option to further renew and extend the term of this Lease from the date upon which it would otherwise expire, for one (1) additional renewal period which shall be for a period of five (5) years (the "Third Renewal Period"). The Third Renewal Period shall follow consecutively upon the expiration of the Second Renewal Period as hereinabove provided and such Third Renewal Period shall, upon commencement thereof, be deemed included in references to "the term of this Lease" and "the full term of this Lease". Tenant's said option with respect to the Third Renewal Period shall be exercised by Tenant giving written notice to Landlord of Tenant's exercise of same not later than nine (9) months prior to the expiration date of the Second Renewal Period. Time is of the essence with respect to such notice, and failure of Tenant to give such notice at least nine (9) months prior to the expiration of the Second Renewal Period shall constitute a binding and conclusive waiver of Tenant's option with respect to such Third Renewal Period. The option to renew and extend the term of this Lease as hereinabove provided shall not be deemed validly exercised unless Tenant shall not be in default at the time of either the exercise of such renewal option or the commencement of the Third Renewal Period. If Tenant elects to exercise said renewal option, the full term of this Lease shall be automatically extended for the Third Renewal Period without the need for the execution of an extension or renewal lease. The Third Renewal Period shall be on all of the same terms and conditions as are in effect hereunder immediately preceding the commencement date of the Third Renewal Period, except that the Fixed Rent during the Third Renewal Period shall be as provided in subparagraph (b) of Paragraph 2 hereinbelow. All provisions for the payment of additional rent shall continue to apply without limitation except as otherwise provided herein. Tenant shall have no further right or option to renew the term of this Lease after the expiration of the Third Renewal Period.

2. Fixed Rent. (a) Tenant covenants to pay to Landlord for and during each lease year of the Second Renewal Period, Fixed Rent at the rate of One Hundred Thousand Six Hundred Thirty Six and 50/100 (\$100,636.50) Dollars per annum (\$8,386.38 per month).

(b) If Tenant exercises its option to extend the term of the Lease for the Third Renewal Period, the Fixed Rent for each lease year of the Third Renewal Period shall be the greater of: (i) the annual amount determined by multiplying the gross rentable area of the Premises by \$17.25 per square foot, or (ii) the then existing fair market rental value of the Premises determined in accordance with the provisions of subparagraph (c) of this Paragraph 2.

(c) The fair market rental value of the Premises, as contemplated by subparagraph (b) of this Paragraph 2, shall be determined as follows: Promptly after receipt by Landlord of Tenant's notice of Tenant's exercise of its option to renew and extend the term of this Lease pursuant to the provisions of subparagraph (b) of Paragraph 1 hereinabove, Landlord shall notify Tenant of Landlord's determination of the fair market rental value of the Premises as of the commencement date of the Third Renewal Period. Tenant shall have the right, by notice to Landlord given within twenty (20) days after receiving Landlord's notice of the fair market rental value to object to the amount thereof. Failure by Tenant to give notice of objection within such twenty (20) day period (time being of the essence) shall constitute an acceptance by Tenant of the fair market rental value as determined by Landlord. If Tenant shall so object, Tenant shall, at its cost and expense, engage an appraiser who is a member of the appraisal institute and who has at least five (5) years experience in the appraisal of office buildings in the Middlesex County, New Jersey area, to determine the fair market rental value of the Premises as of the commencement of the Third Renewal Period. Such appraiser shall render his or her report to Landlord and Tenant not later than thirty (30) days after the date of Tenant's notice of objection to the fair market rental value as determined by Landlord. If such appraiser shall fail to render such report within such thirty (30) day period (time being of the essence), Tenant's objection to the fair market rental value as determined by Landlord shall conclusively be deemed to have been waived and the rental for the Third Renewal Period shall be as determined by Landlord. If the appraiser shall render his or her report within such thirty (30) day period and the fair market rental value so determined shall not be acceptable to Landlord, Landlord shall have the right to so notify Tenant, and Landlord shall then, at its cost and expense, engage an appraiser (having the same qualifications as those set forth above) to determine the fair market rental value of the Premises. In the event that the two appraisers shall determine a fair market rental value which shall not differ by more than ten (10%) percent, the fair market rental value shall be deemed to be the average of the two appraisals. If the two appraisals shall differ by more than such ten (10%) percent amount, then the two appraisers shall select a third appraiser with similar qualifications, with Landlord and Tenant each to pay one-half of the cost of such third appraiser, and the fair market rental value of the Premises as determined by such third appraiser shall be binding and conclusive upon Landlord and Tenant. The appraiser for Landlord and the appraiser for Tenant shall select such third appraiser within ten (10) days after Landlord notifies Tenant that such third appraisal is required. The said third appraiser shall be instructed to render his or her report to Landlord and Tenant not later than thirty (30) days after the date of his or her engagement.

3. Additional Rent. All provisions for the payment of additional rent set forth in the Lease, including, without limitation, all provisions pertaining to the payment of "Operating Costs" and "taxes" (as said terms are defined in Article 18 of the Lease) shall continue to apply without modification.

4. Brokerage Commission. Tenant warrants and represents that it has not dealt or negotiated with any real estate broker or salesman in connection with this Agreement other than Newmark JGT of New Jersey, LLC (the "Broker") or representatives thereof. Tenant shall and hereby does indemnify and hold Landlord harmless from and against any real estate commissions, fees, charges or the like, or claims therefor, including any and all costs incurred in connection therewith, arising out of the within transaction payable to any party other than the Broker except to the extent any such claim or commission is based solely upon Landlord's acts. Landlord shall pay any commission due to the Broker pursuant to a separate agreement.

5. Landlord's Work. Landlord shall, at its cost and expense, perform the following work at the Premises ("Landlord's Work"): (i) relocate one (1) thermostat from the adjoining premises to the Premises, (ii) paint the interior walls of the Premises using building

standard materials. Tenant shall select the wall and trim paint colors and shall be solely responsible for moving all furniture, equipment and other personal property so as to enable Landlord to so paint the Premises. It is expressly understood and agreed to by and between the parties hereto that, except for Landlord's Work, Tenant shall continue in possession of the Premises in its present condition "as is", and Landlord shall not be obligated to perform any additional work of any type or nature whatsoever in connection with this Agreement. Tenant shall, at its cost and expense, obtain any governmental permits and approvals which may be required for its continued or occupancy of the Premises.

6. Right of First Notification. The Right of First Notification, set forth in the First Modification, shall continue to apply during the Second Renewal Period.

7. Defined Terms. The terms used in this Agreement and not defined herein shall have the respective meanings indicated in the Lease, unless the context requires otherwise.

8. No Other Changes. The intent of this Agreement is only to modify and amend those provisions of the Lease as herein specified. Except as herein specifically modified, changed and amended, all of the terms and conditions of the Lease shall remain in full force and effect.

IN WITNESS WHEREOF, the parties hereto have duly executed this Second Modification and Extension of Lease as of the day and year first above written.

WITNESS:

/s/ [ILLEGIBLE]

METROPLEX ASSOCIATES
(Landlord)

By: /s/ [ILLEGIBLE]

David Halpern, Partner

ATTEST:

By: _____
Name: _____
Title: _____

HANOVER CAPITAL MORTGAGE CORP.
(Tenant)

By: /s/ [ILLEGIBLE]

[ILLEGIBLE]

THIRD MODIFICATION OF LEASE AGREEMENT

This Third Modification of Lease Agreement ("Agreement"), made this 8 day of May, 2002, by and between METROPLEX ASSOCIATES, a New Jersey partnership, having an address c/o of Atlantic Realty Development Corp., 90 Woodbridge Center Drive, Woodbridge, New Jersey 07095 (the "Landlord"), and HANOVER CAPITAL MORTGAGE CORP., a Missouri corporation, having an address at Metroplex Corporate Center I, 100 Metroplex Drive, Edison, New Jersey 08817 (the "Tenant").

W I T N E S S E T H:

WHEREAS, by lease dated March 9, 1994 (the "Original Lease"), Landlord leased to Tenant and Tenant hired from Landlord certain premises (the "Original Space") having a gross rentable area of approximately 5,834 square feet constituting a portion of the third floor of the building (the "Building") known as Metroplex Corporate Center I, 100 Metroplex Drive, Edison, New Jersey 08817; and

WHEREAS, by document entitled "First Modification and Extension of Lease%, Agreement", dated February 28, 1997 (the "First Modification"), the term of the Lease was extended until 6:00 p.m. on June 30, 2002; and

WHEREAS, by document entitled "Second Modification and Extension of Lease Agreement", dated April 22, 2002 (the "Second Modification"), the term of the Lease was extended until 6:00 p.m. on April 30, 2005; and

WHEREAS, the Lease, the First Modification and the Second Modification are herein collectively referred to as the "Lease"; and

WHEREAS, Landlord and Tenant desire to further modify the Lease as hereinafter provided;

NOW, THEREFORE, for and in consideration of the above premises, the mutual covenants hereinafter contained, and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, Landlord and Tenant hereby agree as follows:

1. Premises. Commencing on May 3, 2002, (the "Additional Space Commencement Date"), the definition and description of the Premises in the Lease shall be modified and amended to include certain additional premises having a gross rentable area of approximately 777 square feet located on the third floor of the Building (the "Additional Space"), which Additional Space is more particularly described on Exhibit A annexed hereof. As a result of the foregoing, the definition and description of the Premises in the Lease shall, as of the Additional Space Commencement Date, refer to the Original Space described in the Original Lease together with the Additional Space described herein, and shall have a gross rentable area of approximately 6,611 square feet.

2. Term. (a) The term for the Additional Space shall commence on the Additional Space Commencement Date and shall be co-terminus with the term of the Lease for the Original Space (ie., expiring at 6:00 p.m. on April 30, 2005), subject to any renewal thereof.

(b) Landlord may not be able to deliver possession of the Additional Space to Tenant on the date specified hereinabove as the Additional Space Commencement Date by reason of Landlord's inability to obtain actual possession of the Additional Space from any existing tenant, by reason of Landlord's failure to substantially complete Landlord's Additional Space Work (as hereinafter defined), or for any other reason. Landlord shall not be liable to Tenant if Landlord does not deliver possession of the Additional Space to Tenant on the date specified hereinabove as the Additional Space Commencement Date. In such event, the Additional Space Commencement Date shall be delayed until possession of the Additional Space is delivered to

Tenant but the term for the Additional Space shall not be extended and shall remain co-terminus with the term of the Lease for the Original Space.

3. Fixed Rent. (a) Commencing on the Additional Space Commencement Date and ending on April 30, 2005, Tenant shall pay to Landlord annual Fixed Rent for the Additional Space in an amount equal to the product of the gross rentable area of the Additional Space multiplied by \$17.25 per square foot (ie. 777 square feet x \$17.25 = \$13,403.25 per annum/\$1,116.94 per month). Fixed Rent for the Additional Space for the month of May, 2002 shall be prorated. In addition to the Fixed Rent payable for the Additional Space, as hereinabove set forth, Tenant shall continue to pay to Landlord annual Fixed Rent for the Original Space at the rates set forth in the First Modification and the Second Modification.

(b) Fixed Rent shall be payable in equal monthly installments, as aforesaid, in advance on the first day of each and every calendar month of the term of the Lease in lawful money of the United States of America in the office of Landlord or at such other place as may hereafter be designated by Landlord. Fixed Rent shall be paid to Landlord without notice or demand and without deduction, setoff or other charge therefrom or against the same.

4. Proportionate Share. The Lease is amended to provide that effective as of the Additional Space Commencement Date, Tenant's Proportionate Share, as defined in Article 3 of the Original Lease, shall be changed from 4.64% to 5.25%.

5. Insurance. The Lease is supplemented to provide that Tenant shall, at its cost and expense, procure all policies of insurance for the purpose of insuring the Additional Space in accordance with the terms set forth in Article 4 of the Original Lease. Policies of such insurance, or certificates thereof, together with reasonable evidence of premium payment therefor, shall be delivered to Landlord upon execution of this Agreement.

6. Additional Rent. All provisions for the payment of additional rent set forth in the Lease, including, without limitation, all provisions pertaining to the payment of "Operating Costs" and "taxes" (as said terms are defined in Article 18 of the Lease) shall continue to apply without modification, except as may be set forth herein.

7. Electric Charges. The Lease is supplemented to provide that from and after the Additional Space Commencement Date, in addition to Tenant's obligation to pay all charges for electricity, light, heat or other utility used by Tenant at the Original Space, Tenant shall also pay, as additional rent, all charges for electricity, light, heat or other utility used by Tenant at the Additional Space. If electric energy consumed in the Additional Space is not separately metered, either by the utility company or by Landlord, and billed to Tenant, Tenant shall pay Landlord for such electric energy the sum of \$971.25 per annum (ie , \$1.25 per square foot of gross rentable area of the Additional Space) in equal monthly installments of \$80.94 each on the first day of each month during the term of the Lease commencing on the Additional Space Commencement Date. Such sum of \$971.25 shall be subject to increase in accordance with increases in electric charges payable by Landlord. In addition, either Landlord or Tenant may, at any time, at its sole cost and expense, engage an electrical consultant, approved by Landlord, to make a survey of the electric energy demand in the Additional Space and to determine the average monthly electric consumption in the Additional Space. The findings of said consultant as to the average monthly electric consumption of Tenant shall be deemed conclusive and binding upon the parties. From and after said consultant has submitted its report, Tenant shall pay to Landlord, as additional rent, on the first day of each month during the balance of the term of the Lease (or until another such survey is performed or a separate electric meter is installed for the Additional Space), in advance, the amount set forth in the survey as the monthly electric consumption.

8. Brokerage Commission. Tenant warrants and represents that it has not dealt or negotiated with any real estate broker or salesman in connection with this Agreement other than Newmark JGT of New Jersey, LLC (the "Broker") or representatives thereof. Tenant shall and hereby does indemnify and hold Landlord harmless from and against any real estate commissions, fees, charges or the like, or claims therefor, including any and all costs incurred in connection

therewith, arising out of the within transaction payable to any party other than the Broker except to the extent any such claim or commission is based solely upon Landlord's acts. Landlord shall pay any commission due to the Broker pursuant to a separate agreement.

9. Landlord's Additional Space Work. Landlord shall, at its cost and expense, perform the following work at the Additional Space ("Landlord's Additional Space Work"): (i) paint the interior of the Additional Space using Building standard paint, (ii) remove the existing carpet and install new carpet at the Additional Space using Building standard materials, and (iii) replace one (1) missing window blind at the Additional Space. It is expressly understood and agreed to by and between the parties hereto that, except for Landlord's Additional Space Work, Tenant shall accept possession of the Additional Premises in its present condition "as is", and Landlord shall not be obligated to perform any additional work of any type or nature whatsoever in connection with this Agreement. Tenant shall, at its cost and expense, obtain any governmental permits and approvals which may be required for its use or occupancy of the Additional Space.

10. Right of First Notification. Tenant's Right of First Notification, set forth in the First Modification and the Second Modification, shall not apply to the Additional Space.

11. Defined Terms. The terms used in this Agreement and not defined herein shall have the respective meanings indicated in the Lease, unless the context requires otherwise.

12. No Other Changes. The intent of this Agreement is only to modify and amend those provisions of the Lease as herein specified. Except as herein specifically modified, changed and amended, all of the terms and conditions of the Lease shall remain in full force and effect.

IN WITNESS WHEREOF, the parties hereto have duly executed this Third Modification and Extension of Lease as of the day and year first above written.

WITNESS: METROPLEX ASSOCIATES (Landlord)
/s/ [ILLEGIBLE] By: /s/ David Halpern, Partner
----- David Halpern, Partner

ATTEST: HANOVER CAPITAL MORTGAGE CORP. (Tenant)
By: _____ By: /s/ [ILLEGIBLE]
Name: _____ [ILLEGIBLE]
Title: _____

EXHIBIT A
ADDITIONAL SPACE

[FLOOR MAP]

FOURTH MODIFICATION OF LEASE AGREEMENT

This Fourth Modification of Lease Agreement ("Agreement"), made this day of November, 2002, by and between METROPLEX ASSOCIATES, a New Jersey partnership, having an address c/o of Atlantic Realty Development Corporation, 90 Woodbridge Center Drive, Woodbridge, New Jersey 07095 (the "Landlord"), and HANOVER CAPITAL MORTGAGE CORPORATION., a Missouri corporation, having an address at Metroplex Corporate Center I, 100 Metroplex Drive, Edison, New Jersey 08817 (the "Tenant").

W I T N E S S E T H:

WHEREAS, by lease dated March 9, 1994 (the "Original Lease"), Landlord leased to Tenant and Tenant hired from Landlord certain premises (the "Original Space") having a gross rentable area of approximately 5,834 square feet constituting a portion of the third floor of the building (the "Building") known as Metroplex Corporate Center I, 100 Metroplex Drive, Edison, New Jersey 08817; and

WHEREAS, by document entitled "First Modification and Extension of Lease Agreement", dated February 28, 1997 (the "First Modification"), the term of the Lease was extended until 6:00 p.m. on June 30, 2002; and

WHEREAS, by document entitled "Second Modification and Extension of Lease Agreement", dated April 22, 2002 (the "Second Modification"), the term of the Lease was extended until 6:00 p.m. on April 30, 2005; and

WHEREAS, by document entitled "Third Modification of Lease Agreement", dated May 8, 2002 (the "Third Modification"), Landlord leased to Tenant certain additional space having a gross rentable area of approximately 777 square feet located on the third floor of the Building (the "Additional Space"); and

WHEREAS, the Original Space and the Additional Space are herein collectively referred to as the "Premises"); and

WHEREAS, the Original Lease, the First Modification, the Second Modification and the Third Modification are herein collectively referred to as the "Lease"; and

WHEREAS, Landlord and Tenant desire to further modify the Lease as hereinafter provided;

NOW, THEREFORE, for and in consideration of the above premises, the mutual covenants hereinafter contained, and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, Landlord and Tenant hereby agree as follows:

1. Premises. Upon the New Space Commencement Date (as said term is hereinafter defined), the definition and description of the Premises in the Lease shall be modified and amended (i) to delete the Additional Space, and (ii) to include certain additional premises having a gross rentable area of approximately 3,890 square feet constituting a portion of the second floor of the Building (the "New Space"), which New Space is more particularly described on Exhibit A annexed hereto. As a result of the foregoing, the definition and description of the Premises in the Lease, shall, as of the New Space Commencement Date, refer to the Original Space described in the Original Lease together with the New Space described herein, and shall have a gross rentable area of approximately 9,724 square feet.

2. Term. (a) The term for the New Space shall commence on the date (the "New Space Commencement Date") Landlord delivers possession of the New Space to Tenant with the New Space Work (as said term is hereinafter defined), exclusive of so-called "punchlist" items, substantially completed. The New Space Work shall be deemed substantially completed at such time as the only items of New Space Work to be completed are those which will not

substantially interfere with Tenant's use and occupancy of the New Space. Notwithstanding the foregoing, should Landlord be delayed in delivering possession of the New Space to Tenant, or in substantially completing the New Space Work, by reason of Tenant's delay, lack of cooperation, request for changes in the New Space Work, or the performance of work by anyone employed or engaged by Tenant, or by reason of any other act or omission of Tenant, the New Space Commencement Date shall be the date which is the earlier of (i) the date when Landlord delivers possession of the New Space to Tenant with the New Space Work, exclusive of so-called "punchlist" items, substantially completed as hereinabove provided, or (ii) the date when Landlord would have delivered possession of the New Space to Tenant with the New Space Work, exclusive of so-called "punchlist" items, substantially completed but for the occurrence of any Tenant delay referred to above. The term for the New Space shall be co-terminus with the term of the Lease (ie, expiring at 6:00 p.m. on April 30, 2005).

(b) On the New Space Commencement Date, the Lease shall be terminated with respect to the Additional Space. All Fixed Rent, additional rent and other charges required to be paid by Tenant with respect to the Additional Space shall be paid and all of Tenant's other obligations under the Lease with respect to the Additional Space shall be performed, up to and including the New Space Commencement Date. Tenant shall, on or before the New Space Commencement Date, surrender the Additional Space to Landlord in the condition in which the Premises are required to be surrendered by Tenant in accordance with the provisions of the Lease. Failure of Tenant to comply with its obligations pursuant to this Section 2(b) shall constitute a default by Tenant under the Lease. In addition, in the event Tenant fails to surrender the Additional Space to Landlord as aforesaid on or before the New Space Commencement Date, in addition to any damages to which Landlord may be entitled or other remedies Landlord may have by law, Tenant shall pay to Landlord a rental for the period it remains in possession of the Additional Space after the New Space Commencement Date, at the rate of (i) twice the Fixed Rent then being paid by Tenant allocable to the Additional Space, plus (ii) all items of additional rent and other charges then being paid by Tenant allocable to the Additional Space. Nothing herein contained shall be deemed to give Tenant any right to remain in possession of the Additional Space after the New Space Commencement Date. Landlord shall not be required to deliver possession of the New Space to Tenant unless and until Tenant has complied with its obligations pursuant to this Section 2(b); however, in no event will the New Space Commencement Date be delayed as a result thereof.

3. Fixed Rent. (a) Commencing on the New Space Commencement Date and continuing through April 30, 2005, Tenant shall pay to Landlord Fixed Rent for the New Space in an amount equal to the product of the gross rentable area of the New Space multiplied by \$15.50 per square foot (ie. 3,890 square feet x \$15.50 = \$60,295.00 per annum/\$5,024.58 per month). In addition to the Fixed Rent payable for the New Space as hereinabove set forth, Tenant shall continue to pay to Landlord Fixed Rent for the Original Space at the rates set forth in the Second Modification.

(b) Fixed Rent shall be payable in equal monthly installments, as aforesaid, in advance on the first day of each and every calendar month of the term of the Lease in lawful money of the United States of America in the office of Landlord or at such other place as may hereafter be designated by Landlord. Fixed Rent shall be paid to Landlord without notice or demand and without deduction, setoff or other charge therefrom or against the same.

4. Proportionate Share. The Lease is amended to provide that effective as of the New Space Commencement Date, provided that Tenant has vacated the Additional Space in accordance with the terms hereof, Tenant's Proportionate Share, as defined in Article 3 of the Original Lease, shall be changed from 5.25 % to 7.73 %. If Tenant has not vacated the Additional Space in accordance with the terms hereof, Tenant's Proportionate Share shall be 8.35 % until such time as Tenant vacates the Additional Space in accordance with the terms hereof.

5. Insurance. The Lease is supplemented to provide that Tenant shall, at its cost and expense, procure all policies of insurance for the purpose of insuring the New Space in accordance with the terms set forth in Article 4 of the Original Lease. Policies of such insurance,

or certificates thereof, together with reasonable evidence of premium payment therefor, shall be delivered to Landlord upon execution of this Agreement.

6. Additional Rent. All provisions for the payment of additional rent set forth in the Lease, including, without limitation, all provisions pertaining to the payment of "Operating Costs" and "taxes" (as said terms are defined in Article 18 of the Lease) shall continue to apply without modification, except as may be set forth herein.

7. Electric Charges. The Lease is supplemented to provide that from and after the New Space Commencement Date, in addition to Tenant's obligation to pay all charges for electricity, light, heat or other utility used by Tenant at the Original Space, Tenant shall also pay, as additional rent, all charges for electricity, light, heat or other utility used by Tenant at the New Space. If electric energy consumed in the New Space is not separately metered, either by the utility company or by Landlord, and billed to Tenant, Tenant shall pay Landlord for such electric energy the sum of \$4,862.50 per annum (ie, \$1.25 per square foot of gross rentable area of the New Space) in equal monthly installments of \$405.21 each on the first day of each month during the term of the Lease commencing on the New Space Commencement Date. Such sum of \$4,862.50 shall be subject to increase in accordance with increases in electric charges payable by Landlord. In addition, either Landlord or Tenant may, at any time, at its sole cost and expense, engage an electrical consultant, approved by Landlord, to make a survey of the electric energy demand in the New Space and to determine the average monthly electric consumption in the New Space. The findings of said consultant as to the average monthly electric consumption of Tenant shall be deemed conclusive and binding upon the parties. From and after said consultant has submitted its report, Tenant shall pay to Landlord, as additional rent, on the first day of each month during the balance of the term of the Lease (or until another such survey is performed or a separate electric meter is installed for the New Space), in advance, the amount set forth in the survey as the monthly electric consumption.

8. Brokerage Commission. Tenant warrants and represents that it has not dealt or negotiated with any real estate broker or salesman in connection with this Agreement other than Newmark Real Estate of New Jersey, L.L.C. (the "Broker") or representatives thereof. Tenant shall and hereby does indemnify and hold Landlord harmless from and against any real estate commissions, fees, charges or the like, or claims therefor, including any and all costs incurred in connection therewith, arising out of the within transaction payable to any party other than the Broker except to the extent any such claim or commission is based solely upon Landlord's acts. Landlord shall pay any commission due to the Broker pursuant to a separate agreement.

9. New Space Work. Landlord shall, at its cost and expense, perform the following work at the New Space ("New Space Work"): (i) paint throughout the entire New Space plus two (2) rooms in the Original Space using Building standard paint, (ii) tape and glue carpet where necessary in the New Space, and (iii) reinstall lower cabinet door in the New Space. In addition to the New Space Work, Landlord shall, within a reasonable period of time after written request by Tenant, at Tenant's cost and expense, core the floor of the New Space for cables (the "Cable Work"). Landlord's cost to perform the Cable Work shall be based on Landlord's time and materials. Tenant shall pay Landlord Landlord's Cost to perform the Cable Work within ten (10) days of being billed therefor by Landlord. It is expressly understood and agreed to by and between the parties hereto that, except for the New Space Work, Tenant shall accept possession of the New Space in its present condition "as is", and Landlord shall not be obligated to perform any additional work of any type or nature whatsoever in connection with this Agreement. Tenant shall, at its cost and expense, obtain any governmental permits and approvals which may be required for its use or occupancy of the New Space.

10. Right of First Notification. Tenant's Right of First Notification, set forth in the First Modification and the Second Modification, shall not apply to the New Space.

11. Defined Terms. The terms used in this Agreement and not defined herein shall have the respective meanings indicated in the Lease, unless the context requires otherwise.

12. No Other Changes. The intent of this Agreement is only to modify and amend those provisions of the Lease as herein specified. Except as herein specifically modified, changed and amended, all of the terms and conditions of the Lease shall remain in full force and effect.

IN WITNESS WHEREOF, the parties hereto have duly executed this Fourth Modification of Lease Agreement as of the day and year first above written.

WITNESS:

METROPLEX ASSOCIATES
(Landlord)

By: /s/ David Halpern, Partner

David Halpern, Partner

ATTEST:

By: _____
Name: _____
Title: _____

HANOVER CAPITAL MORTGAGE CORP.
(Tenant)

By: /s/ John Burchett,

John Burchett, President

EXHIBIT A
ADDITIONAL SPACE

[FLOOR MAP]

FIRST AMENDMENT TO LEASE
BETWEEN
METRO FOUR ASSOCIATES LIMITED PARTNERSHIP,
AS LANDLORD, AND
PAMEX CAPITAL PARTNERS, L.L.C.,
AS TENANT

THIS FIRST AMENDMENT TO LEASE made this _____day of May, 2000 between METRO FOUR ASSOCIATES LIMITED PARTNERSHIP, a New Jersey Limited Partnership, ("Landlord"), c/o Alfieri Property Management, having an office at 399 Thornall Street, P.O. Box 2911, Edison, New Jersey 08818-2911 and PAMEX CAPITAL PARTNERS, L.L.C., a New Jersey Limited Liability Company, having an office at 379 Thornall Street, Edison, New Jersey ("Tenant").

W I T N E S S E T H:

WHEREAS, Landlord and Tenant entered into a Lease dated September 3, 1997, (the "Lease") wherein Landlord let unto Tenant and Tenant hired from Landlord, 5,200 rentable square feet on a portion of the 2nd floor of a certain office building commonly known and designated as 379 Thornall Street, Edison, New Jersey (the "Building") as set forth on Schedule A attached, for a term which commenced on May 1, 1997 and expires on April 30, 2000; and

WHEREAS, Landlord and Tenant have agreed to extend the term of the Lease and to modify certain provisions of the Lease.

NOW THEREFORE, in consideration of the mutual covenants and undertakings hereinafter set forth by and between the parties hereto, it is agreed as follows:

1. The term of the Lease is hereby extended for sixty (60) months. The Commencement Date of this First Amendment to Lease shall be May 1, 2000 and the Expiration Date shall be April 30, 2005 ("Renewal Period").

2. As of the Commencement Date, Tenant's annual fixed rent shall be \$137,800.00 (calculated on the basis of \$26.50 per square foot for 5,200 rentable square feet) which shall be payable in advance on the first day of each and every month during the term of the Renewal Period in the amount of \$11,483.33.

3. As of the Commencement Date, the Base Year for the calculation of Taxes and Operating Expenses shall be calendar year 2000.

4. Tenant's charge for electricity shall remain at the current rate presently being charged, subject to Article 15 of the Lease.

5. After the execution hereof, Landlord will perform work to the Demised Premises as set forth in Schedule B and Schedule B-1 attached hereto and made a part hereof ("Landlord's Work"). Any cost and expense incurred by Landlord for such improvements as a result of change orders or revisions requested by Tenant shall be the responsibility of Tenant. Landlord's Work shall be done during normal business hours. Tenant shall be responsible for moving all of Tenant's Property in order for Landlord to perform Landlord's Work. Tenant recognizes and agrees that there may be some inconvenience to Tenant during Landlord's Work and agrees that performance of Landlord's Work shall not constitute a actual or constructive eviction in whole or in part, or entitle Tenant to any abatement of rent, or relieve Tenant from any of its obligations under this Lease or impose any liability upon Landlord or its agents.

6. At or before the Expiration Date of the Lease, along with any other restoration required by Landlord pursuant to the Lease or any Tenant Changes, Tenant shall remove from the Demised Premises all equipment comprising Tenant's Voice, Data and Security Systems, including associated outlets, wires, wiring trays and other equipment, materials and facilities, whether located in the ceiling, floor and/or walls which in any way relates, pertains to, constitutes or is connected with Tenant's Voice, Data and/or Security Systems and regardless of whether Landlord or Tenant installed and/or paid for the installation of such systems.

7. Tenant covenants, warrants, and represents that there was no broker except JACOBSON, GOLDFARB & TANZMAN COMPANY, L.L.C. ("Broker") instrumental in consummating this First Amendment to Lease and that no conversations or negotiations were had with any broker except Broker concerning the renewal of the Demised Premises. Tenant agrees to hold Landlord harmless against any claims for a brokerage commission arising out of any conversations or negotiations had by Tenant with any broker except Broker. Landlord agrees to pay Broker pursuant to a separate existing agreement.

8. Except as modified herein, all of the terms, covenants and conditions set forth in the Lease remain in full force and effect.

IN WITNESS WHEREOF, the parties hereto have hereunto set their hands and seals the day and year first above written.

WITNESS: LANDLORD:
METRO FOUR ASSOCIATES
LIMITED PARTNERSHIP,
a New Jersey Limited Partnership

BY: MICHAEL ALFIERI
TITLE: Partner

ATTEST: TENANT:
PAMEX CAPITAL PARTNERS, L.L.C.
A New Jersey Limited Liability Company

[ILLEGIBLE] /s/ JAMES LEBER

By: JAMES LEBER
TITLE: MANAGER

[FLOOR MAP]

SCHEDULE A

SCHEDULE B
LANDLORD'S WORK

1. HVAC - Perimeter baseboard electric heat, central high velocity fan system which utilizes a minimum of 10% to a maximum of 100% fresh air to maintain no less than 68 degrees interior at zero degrees exterior, with a 15-mile per hour wind. Air-cooling shall maintain no more than 78 degrees F dry bulb with approximately 50% relative humidity when the outdoor conditions are 91 degrees F dry bulb. The above heating and cooling standard is for normal office use only which shall be deemed to be one person for every 200 square feet in any given or confined area which shall not include areas with special HVAC requirements such as computer rooms, conference rooms, cafeterias, high density or excessive heat producing equipment. Perimeter baseboard electric heat is used during winter operations and an air cooling system is utilized during summer operations.

One (1) diffuser per 250 sq. ft. of usable area.
2. Window covering - one (1) building-standard Venetian blind per window.
3. Landlord shall complete the interior of the Demised Premises in accordance with space plans and specifications as noted herein, in Schedule A, dated March 27, 2000, and Schedule B-1, dated March 28, 2000. The Landlord's work shall consist of removing an entry door, building of one new wall, some painting and some re-carpeting. Any additional work not specifically noted in the foregoing shall be performed by the Landlord at the Tenant's expense.
4. Tenant further agrees that if an elevator lobby or corridor is included in Tenant's Demised Premises or if by virtue of the size and configuration of Tenant's Demised Premises, other tenants of the Building when in the lobby or corridor can see into Tenant's Demised Premises through a demising wall, Tenant shall not place any window treatments, signs or materials on the exterior glass demising walls unless expressly approved by Landlord in writing. The Landlord shall have the sole and final decision as to the color and design of all paint, furniture, artwork, wall coverings and floor coverings so visible from the lobby or corridor.
5. The Tenant shall be responsible for the telephone and computer installation. The Landlord shall coordinate the timing of these items with the Tenant. The Landlord shall not charge any overhead fees or profit for this work.
6. All changes to Landlord's Work requested by Tenant shall be in writing. Landlord shall advise Tenant before accepting the change, of the cost thereof or, if applicable, the

savings and the delay in the substantial completion, if any, caused by the change and, for any major changes to Landlord's Work, any additional restoration requirements, if any. Tenant shall have five (5) days from receipt of this information from Landlord to advise Landlord to proceed with the change or to withdraw the request. Tenant shall pay the cost of the change order within thirty (30) days after receipt of Landlord's invoice with respect to such change if there shall be an increased cost to Landlord as a result thereof.

[FLOOR MAP]

SCHEDULE B-1

LEASE AGREEMENT

BETWEEN

METRO FOUR ASSOCIATES LIMITED PARTNERSHIP,

AS LANDLORD

-AND-

PAMEX CAPITAL PARTNERS, L.L.C.,

AS TENANT

PREMISES: 379 THORNALL STREET
EDISON, NEW JERSEY
PORTION OF 2ND FLOOR

DATED: SEPTEMBER 3, 1997

INDEX

ARTICLE -----	CAPTION -----	PAGE -----
1	Demised Premises, Term, Rent.....	1
2	Use	3
3	Preparation of the Demised Premises.....	4
4	When Demised Premises Ready for Occupancy.....	4
5	Additional Rent.....	4
6	Subordination, Notice to Lessors and Mortgagees.....	8
7	Quiet Enjoyment.....	9
8	Assignment, Mortgaging, Subletting.....	9
9	Compliance with Laws and Requirements of Public Authorities.....	11
10	Insurance.....	12
11	Rules and Regulations.....	14
12	Tenant's Changes.....	14
13	Tenant's Property.....	16
14	Repairs and Maintenance.....	17
15	Electricity.....	18
16	Heating, Ventilation and Air-Conditioning.....	20
17	Landlord's Other Services.....	20
18	Access, Changes in Building Facilities, Name.....	22
19	Notices of Accidents.....	23
20	Non-Liability and Indemnification.....	23

ARTICLE -----	CAPTION -----	PAGE -----
21	Destruction or Damage.....	24
22	Eminent Domain	25
23	Surrender	27
24	Conditions of Limitation.....	27
25	Re-Entry by Landlord	29
26	Damages.....	30
27	Waivers	31
28	No Other Waivers or Modifications.....	32
29	Curing Tenant's Defaults	33
30	Broker	33
31	Notices	33
32	Estoppel Certificate	34
33	Arbitration.....	34
34	No Other Representations, Construction, Governing Law.....	35
35	Security	36
36	Parties Bound	37
37	Consents	37
38	Mortgage Financing - Tenant Cooperation	38
39	Environmental Compliance	38
40	Holding Over.....	39
41	Certain Definitions & Constructions	39

ARTICLE	CAPTION	PAGE
42	Relocation of Tenant.....	40

- EXHIBIT A - Description of Land
- EXHIBIT B - Floor Plan
- EXHIBIT C - Separate Workletter
- EXHIBIT D - Cleaning and Maintenance Specifications
- EXHIBIT E - Rules and Regulations
- EXHIBIT F - Definitions

(iii)

LEASE, dated September 3 1997, between METRO FOUR ASSOCIATES LIMITED PARTNERSHIP, a New Jersey Limited Partnership, c/o Alfieri Property Management, having its principal office located at 399 Thornall Street, P.O. Box 2911, Edison, New Jersey 08818-2911, ("Landlord"), and PAMEX CAPITAL PARTNERS, L.L.C., a New Jersey Limited Liability Company, having its principal office located at 379 Thornall Street, Edison, New Jersey, ("Tenant").

WITNESSETH:

ARTICLE 1

DEMISED PREMISES, TERM, RENT

1.01. Landlord hereby leases to Tenant, and Tenant hereby hires from Landlord, the premises hereinafter described, in the building located at 379 Thornall Street, Edison, New Jersey, ("Building") on the parcel of land more particularly described in Exhibit A ("Land"), for the term hereinafter stated, for the rents hereinafter reserved and upon and subject to the conditions (including limitations, restrictions and reservations) and covenants hereinafter provided. Each party hereby expressly covenants and agrees to observe and perform all of the conditions and covenants herein contained on its part to be observed and performed.

1.02. The premises hereby leased to Tenant is a portion of the 2nd floor of the Building, as shown on the floor plans annexed hereto as Exhibit B. Landlord and Tenant have mutually agreed that the premises leased has a rentable area of 5,200 square feet which includes Tenant's share of the common area. Said premises, together with all fixtures and equipment which at the commencement, or during the term of this Lease are thereto attached (except items not deemed to be included therein and removable by Tenant as provided in Article 13) constitute the "Demised Premises".

1.03. The term of this Lease, for which the Demised Premises are hereby leased, shall commence on May 1, 1997 ("Commencement Date") and shall end on April 30, 2000, which ending date is hereinafter called the "Expiration Date", or shall end on such earlier date upon which said term may expire or be canceled or terminated pursuant to any of the conditions or covenants of this Lease or pursuant to law.

1.04. The rents reserved under this Lease, for the term thereof, shall be and consist of:

(a) Fixed rent of \$106,600.00 per year, (calculated on the basis of \$20.50/sq. ft. for 5,200 sq. ft. of rentable area) which shall be payable in equal monthly installments of \$8,883.33 in advance on the first day of each and every calendar month during the term of this Lease, (except Tenant shall pay, upon execution and delivery of this Lease by Tenant, the sum of \$8,883.33 to be applied against the first monthly installment or installments of fixed rent becoming due under this Lease) and

(b) Additional rent consisting of all such other sums of money as shall become due from and payable by Tenant to Landlord hereunder (for default in payment of which Landlord shall have the same remedies as for a default in payment of fixed rent),

all to be paid to Landlord at its office, or such other place, or to such agent at such place, as Landlord may designate by notice to Tenant, in lawful money of the United States of America.

1.05. Tenant shall pay the fixed rent and additional rent herein reserved promptly as and when the same shall become due and payable, without demand therefor and without any abatement, deduction or setoff whatsoever except as expressly provided in this Lease.

1.06. If the Commencement Date occurs on a day other than the first day of a calendar month, the fixed rent for such calendar month shall be prorated and the balance of the first month's fixed rent theretofore paid shall be credited against the next monthly installment of fixed rent.

1.07. Late payments of any payment of rent, including monthly rent or any portion thereof, which is not received within ten (10) days after it is due, will be subject to a late charge equal to five percent (5%) of the unpaid payment, or \$100.00, whichever is greater. This amount is in compensation of Landlord's additional cost of processing late payments. In addition, any rent which is not paid when due, including monthly rent, will accrue interest at a late rate charge of First Union Prime Rate plus three percent (3%) per annum, as said rate is reasonably determined by Landlord from published reports, (but in no event in an amount in excess of the maximum rate allowed by applicable law) from the date on which it was due until the date on which it is paid in full with accrued interest. If Tenant is in default of the Lease for failure to pay rent, in addition to the late charges and interest set forth above, Tenant shall be charged with all attorney fees in connection with the collection of all sums due Landlord.

1.08. Landlord, at any time during the term of the Lease, as amended, may recapture a portion of the Demised Premises specified in Exhibit G, Schedule 1 and 2, as BLDG. Services (the "Space") as future Building services. Landlord shall give Tenant written notice of its desire to recapture the Space and Tenant shall vacate the Space within sixty (60) days of receipt of such written notice by Landlord. Any work required as a result of such recapture shall be done by Landlord at Landlord's sole cost and expense. Tenant's rent, including proportional expenses and electric as set forth in Paragraph 1.04(a) above shall be reduced proportionately based on rentable square footage of the Space. Tenant recognizes and agrees that there may be some inconvenience to Tenant as a result of Landlord recapturing the Space and agrees that any work, such as the erection of a demising wall, associated with the recapture shall not constitute a actual or constructive eviction in whole or in part, or entitle Tenant to any abatement of rent, or relieve Tenant from any of its obligations under this Lease or impose any liability upon Landlord or its agents.

ARTICLE 2

USE

2.01. Tenant shall use and occupy the Demised Premises for executive and general offices for the transaction of Tenant's business and for no other purpose.

2.02. The use of the Demised Premises for the purposes specified in Section 2.01 shall not include, and Tenant shall not use or permit the use of the Demised Premises or any part thereof, for:

- (a) A school of any kind other than for the training of Tenant's employees;
- (b) An employment agency; or
- (c) An office for any governmental or quasi governmental bureau, department, agency, foreign or domestic, including any autonomous governmental corporation or diplomatic or trade mission.
- (d) Any telemarketing activities or other direct selling activities; or
- (e) Any use, including executive and general office use, which results in a density of a population of more than one person for every 250 square feet. Notwithstanding the foregoing, Landlord acknowledges that Tenant shall have up to one person for every 200 rentable square feet in the Demised Premises and that such number of individuals violates the aforesaid density requisite. Tenant agrees that it shall not increase the number of individuals in the Demised Premises beyond the density of one person for every 200 rentable square feet. Any sublessee or assignee shall not occupy the Demised Premises at a density greater than one person for every 250 square feet.

2.03. If any governmental license or permit, other than a Certificate of Occupancy, shall be required for the proper and lawful conduct of Tenant's business in the Demised Premises, or any part thereof, and if failure to secure such license or permit would in any way affect Landlord, Tenant, at its expense, shall submit the same to inspection by Landlord. Tenant shall at all times comply with the terms and conditions of each such license or permit.

2.04. Tenant shall not at any time use or occupy, or do or permit anything to be done in the Demised Premises, in violation of the Certificate of Occupancy (or other similar municipal ordinance) governing the use and occupation of the Demised Premises or for the Building.

ARTICLE 3

PREPARATION OF THE DEMISED PREMISES

3.01. Tenant accepts the Demised Premises in "AS-IS" condition and Landlord shall not be responsible in any manner to prepare the Demised Premises in order for Tenant to occupy said Demised Premises.

3.02. On or before the expiration date of this Lease, Tenant shall remove from the Demised Premises all equipment comprising Tenant's Voice, Data and Security Systems, including associated outlets, wires, wiring trays and other equipment, materials and facilities, whether located in the ceiling, floor and/or walls which in any way relates, pertains to, constitutes or is connected with Tenant's Voice, Data and/or Security Systems and regardless of whether Landlord or Tenant installed and/or paid for the installation of such systems.

ARTICLE 4

WHEN DEMISED PREMISES READY FOR OCCUPANCY

INTENTIONALLY DELETED

ARTICLE 5

ADDITIONAL RENT

5.01. For the purpose of Sections 5.01 through 5.03.

(a) "Taxes" shall mean real estate taxes, special and extraordinary assessments and governmental levies against the Land and Building of which the Demised Premises (but excluding therefrom that portion of the real estate taxes directly attributable to improvements made by other tenants in the Building beyond Landlord's allowances) are a part provided, however, if at any time during the term of this Lease the method of taxation prevailing at the date of this Lease shall be altered so that in lieu of, or as an addition to, or as a substitute for any or all of the above there shall be assessed, levied or imposed (i) a tax, assessment, levy, imposition or charge based on the income or rents received therefrom whether or not wholly or partially as a capital levy or otherwise; or (ii) a tax, assessment, levy, imposition or charge measured by or based in whole or in part upon all or any part of the Land and/or Building and imposed upon Landlord; or (iii) a license fee measured by the rents; or (iv) any other tax, assessment, levy, imposition, charge or license fee however described or imposed, then all such taxes, assessments, levies, impositions, charges or license fees or the part thereof so measured or based shall be included in the definition of "Taxes." Tenant shall pay to Landlord directly that portion of any real estate taxes directly attributable to improvements made by Tenant beyond Landlord's allowances (hereinafter referred to as "Tenant's Direct Tax Payment").

(b) "Base Taxes" shall mean the assessed valuation of the Land and Building as finally determined for the Tax Year 1997.

(c) "Tax Year" shall mean each calendar year for which Taxes are levied by any governmental authority.

(d) "Operational Year" shall mean each calendar year commencing with calendar year 1998.

(e) "Tenant's Proportionate Share of Increase" shall mean 1.625% multiplied by the increase in Taxes in any Operational Year in excess of the Base Taxes. Tenant's Proportionate Share of Increase for the first Operational Year shall be prorated to reflect the actual occupancy by Tenant for said Operational Year.

(f) "Tenant's Projected Share of Increase" shall mean Tenant's Proportionate Share of Increase in Taxes for the projected Operational Year divided by twelve (12) and payable monthly by Tenant to Landlord as additional rent.

5.02. Commencing with the first Operational Year and thereafter, Tenant shall pay to Landlord as additional rent for the then Operational Year, Tenant's Projected Share of Increase in Taxes in equal monthly installments.

5.03. After the expiration of each Operational Year, Landlord shall furnish to Tenant a written statement of the Taxes incurred for such Operational Year as well as Tenant's Proportionate Share of Increase, if any. If the statement furnished by Landlord to Tenant pursuant to this Section at the end of the then Operational Year shall indicate that Tenant's Projected Share of Increase exceeded Tenant's Proportionate Share of Increase, Landlord shall either forthwith pay the amount of excess directly to Tenant concurrently with the statement or credit same against Tenant's next monthly installment of rent. If such statement furnished by Landlord to Tenant shall indicate that the Tenant's Proportionate Share of Increase exceeded Tenant's Projected Share of Increase for the then Operational Year, Tenant shall forthwith pay the amount of such excess to Landlord.

Commencing with the first Operational Year, Tenant shall pay to Landlord in equal monthly installments together with its payment of fixed rent one-twelfth (1/12) of Tenant's Direct Tax Payment.

5.04. As used in Sections 5.04 through 5.06:

(a) "Operating Expenses" shall mean any or all expenses incurred by Landlord in connection with the operation of the Land and Building of which the Demised Premises are a part, including all expenses incurred as a result of Landlord's compliance with any of its obligations hereunder and such expenses shall include: (i) salaries, wages, medical, surgical and general welfare benefits, (including group life insurance) and pension payments of employees of Landlord engaged in the operation and maintenance of the Building; (ii) social security, unemployment, and payroll taxes, workers' compensation, disability coverage, uniforms, and dry cleaning for the employees referred to in Subsection (i); (iii) the cost for the Building and common areas of all charges for oil, gas, electricity (including, but not limited to, fuel cost

adjustments), steam, heat, ventilation, air-conditioning, heating, and water including any taxes on any such utilities, but excluding from Operating Expenses the Landlord's cost, including taxes thereon, of electric energy, other than for heating and air-conditioning, furnished to the Demised Premises (which electric energy so furnished shall be paid for by Tenant pursuant to the provisions of Article 15 hereof); (iv) the cost of all premiums and charges for the following insurances rent, casualty, liability, fidelity and war risk (if obtainable from the United States Government); (v) the cost of all building and cleaning supplies for the common areas of the Building and charges for telephone for the Building; (vi) the cost of all charges for management, window cleaning, security services, if any, and janitorial services, and any independent contractor performing work included within the definition of operating expenses; (vii) legal and accounting services and other professional fees and disbursements incurred in connection with the operation and management of the Land and Building (other than as related to new leases, enforcing Landlord's rights under existing leases, or sales of the Building); (viii) general maintenance of the Building and the cost of maintaining and replacing the landscaping; (ix) maintenance of the common area; and (x) the cost of capital expenditures, including the purchase of any item of capital equipment or the leasing of capital equipment which have the effect of reducing the expenses which would otherwise be included in Operating Expenses, which costs shall be included in Operating Expenses for the Operational Year in which the costs are incurred and subsequent Operational Years on a straight-line basis, to the extent that such items are amortized over such period of time as Landlord reasonably estimates, with an interest factor equal to the interest rate at the time of Landlord's having made said expenditure.

If during all or part of any Operational Year, Landlord shall not furnish any particular item(s) of work or service (which would otherwise constitute an Operating Expense hereunder) to portions of the Building due to the fact that (i) such portions are not occupied or leased; (ii) such items of work or service is not required or desired by the tenant of such portion; (iii) such tenant is itself obtaining and providing such item of work or service; or (iv) for other reasons, then, for the purposes of computing Operating Expenses, the amount for such item and for such period shall be deemed to be increased by an amount equal to the additional costs and expenses which would reasonably have been incurred during such period by Landlord if it had at its own expense furnished such item of work or services to such portion of the Building or such tenant.

Notwithstanding the foregoing, the following costs and expenses shall not be included in Operating Expenses:

- (1) Executives' salaries above the grade of building manager;
- (2) Amounts received by Landlord through proceeds of insurance except to the extent they are compensation for sums previously included in Operating Expenses hereunder,
- (3) Cost of repairs or replacements incurred by reason of fire or other casualty or condemnation to the extent Landlord is compensated therefor;
- (4) Advertising and promotional expenditures;

(5) Costs incurred in performing work or furnishing services for any tenant (including Tenant), whether at such tenant's or Landlord's expense, to the extent that such work or service is in excess of any work or service that Landlord is obligated to furnish to tenant at Landlord's expense;

(6) Depreciation, except as provided above;

(7) Brokerage commissions;

(8) Taxes (as hereinbefore defined);

(9) The cost of electricity (for other than heating and air-conditioning) furnished to the Demised Premises or any other space leased to tenants as reasonably estimated by Landlord; and

(10) Refinancing costs and mortgage interest and amortization payments.

(b) "Operational Year" shall mean each calendar year commencing with calendar year 1998.

(c) "Base Year" shall mean calendar year 1997.

(d) "Tenant's Proportionate Share of Increase" shall mean 1.625% multiplied by the increase in Operating Expenses for the Operational Year over Operating Expenses for the Base Year. For purposes hereof the Tenant's Proportionate Share of Increase has been computed based upon a total square footage of the Building equal to 320,000 square feet, and a total square footage of the Demised Premises equal to 5,200 square feet.

(e) "Tenant's Projected Share of Increase" shall mean Tenant's Proportionate Share of Increase for the projected Operational Year divided by twelve (12) and payable monthly by Tenant to Landlord as additional rent.

5.05. Commencing with the first Operational Year after Landlord shall be entitled to receive Tenant's Proportionate Share of Increase, Tenant shall pay to Landlord as additional rent for the then Operational Year, Tenant's Projected Share of Increase.

5.06. After the expiration of the first Operational Year and for each Operational Year thereafter, Landlord shall furnish to Tenant a written detailed statement of the Operating Expenses (certified to be true and correct by Landlord) incurred for such Operational Year which statement shall set forth Tenant's Proportionate Share of Increase, if any. If the statement furnished by Landlord to Tenant, pursuant to this Section, at the end of the then Operational Year shall indicate that Tenant's Projected Share of Increase exceeded Tenant's Proportionate Share of Increase, Landlord shall either forthwith pay the amount of excess directly to Tenant concurrently with the statement or credit same against Tenant's next monthly installment of rent. If such

statement furnished by Landlord to Tenant hereunder shall indicate that the Tenant's Proportionate Share of Increase exceeded Tenant's Projected Share of Increase for the then Operational Year, Tenant shall forthwith pay the amount of such excess to Landlord.

5.07. Every statement given by Landlord pursuant to Sections 5.03 and 5.06 shall be conclusive and binding upon Tenant unless (i) within ninety (90) days after the receipt of such statement Tenant shall notify Landlord that it disputes the correctness of the statement, specifying the particular respects in which the statement is claimed to be incorrect; and (ii) if such dispute shall not have been settled by agreement, shall submit the dispute to judicial proceedings within one hundred and twenty (120) days after receipt of the statement. Within such 90 day period Tenant shall have the right to review, examine and audit Landlord's books and records for the applicable calendar year. Tenant agrees that it and its representatives shall conduct a review with complete confidentiality and shall enter into a reasonable confidentiality agreement with Landlord respecting the review, examination and audit. Pending the determination of such dispute by agreement or judicial proceedings as aforesaid, Tenant shall, within thirty (30) days after receipt of such statement, pay additional rent in accordance with Landlord's statement and such payment shall be without prejudice to Tenant's position. If the dispute shall be determined in Tenant's favor, Landlord shall forthwith pay Tenant the amount of Tenant's overpayment of rents resulting from compliance with Landlord's statement.

ARTICLE 6

SUBORDINATION, NOTICE TO LESSORS AND MORTGAGEES

6.01. This Lease, and all rights of Tenant hereunder are and shall be subject and subordinate in all respects to all ground leases, overriding leases and underlying leases of the Land and/or the Building now or hereafter existing and to all mortgages which may now or hereafter affect the Land and/or the Building and/or any of such leases, whether or not such mortgages shall also cover other lands and/or buildings, to each and every advance made or hereafter to be made under such mortgages, and to all renewals, modifications, replacements, and extensions of such leases and such mortgages and spreaders and consolidations of such mortgages. This Section shall be self-operative and no further instrument of subordination shall be required. In confirmation of such subordination, Tenant shall promptly execute and deliver an instrument that Landlord, the lessor of any such lease or the holder of any such mortgage or any of their respective successors in interest may reasonably request to evidence such subordination. The leases to which this Lease is, at the time referred to, subject and subordinate pursuant to this Article are hereinafter sometimes called "superior leases" and the mortgages to which this Lease is, at the time referred to, subject and subordinate are hereinafter sometimes called "superior mortgages", the lessor of a superior lease or its successor in interest at the time referred to is sometimes hereinafter called a "lessor", and the holder of a superior mortgage or its successor in interest at the time referred to is sometimes hereinafter called a "superior mortgagee."

ARTICLE 7

QUIET ENJOYMENT

7.01. So long as Tenant pays all of the fixed rent and additional rent due hereunder and performs all of Tenant's other obligations hereunder, Tenant shall peaceably and quietly have, hold, and enjoy the Demised Premises subject, nevertheless, to the obligations of this Lease and, as provided in Article 6, to the superior leases and the superior mortgages.

ARTICLE 8

ASSIGNMENT, MORTGAGING, SUBLETTING

8.01. Neither this Lease, nor the term and estate hereby granted, nor any part hereof or thereof, nor the interest of Tenant in any sublease, or the rentals thereunder, shall be assigned, mortgaged, pledged, encumbered or otherwise transferred by Tenant, and neither the Demised Premises, nor any part thereof shall be encumbered in any manner by reason of any act or omission on the part of Tenant or anyone claiming under or through Tenant or shall be sublet, or offered or visibly advertised from the Demised Premises for subletting, or be used or occupied or permitted to be used or occupied, or utilized for desk space or for mailing privileges, by anyone other than Tenant or for any purpose other than as permitted by this Lease, without the prior written consent of Landlord in every case, except as expressly otherwise provided in this Article. Landlord's consent to a sublease or an assignment of the Demised Premises shall not be unreasonably withheld. Landlord shall not be deemed unreasonable for the purposes of consent for a sublease or an assignment if Landlord withholds its consent for any of the following: (i) in Landlord's belief the sublessee or assignee is known as a poor tenant; (ii) the sublessee's or assignee's use will burden the parking facilities of the Building; (iii) the sublessee's or assignee's use will violate any provision of this Lease; (iv) if such sublessee or assignee is an environmental nuisance; (v) if in Landlord's discretion the Landlord does not find that the financial capacity of the sublessee or assignee is adequate; or (vi) for any other reason which shall not be unreasonable for Landlord to withhold its consent.

8.02. If this Lease be assigned, whether or not in violation of the provisions of this Lease, Landlord may collect rent from the assignee. If the Demised Premises or any part thereof be sublet or be used or occupied by anybody other than Tenant, whether or not in violation of this Lease, Landlord may, after default by Tenant and expiration of Tenant's time to cure such default, collect rent from the undertenant or occupant. In either event, Landlord may apply the net amount collected to the rents herein reserved, but no such assignment, underletting, occupancy or collection shall be deemed a waiver of any of the provisions of Section 8.01, or the acceptance of the assignee, undertenant or occupants as Tenant, or a release of Tenant from the further performance by Tenant of Tenant's obligations under this Lease. The consent by Landlord to assignment, mortgaging, underletting or use or occupancy by others shall not in any way be considered to relieve Tenant from obtaining the express written consent of Landlord to any other or further assignment, mortgaging or underletting or use or occupancy by others not expressly permitted by this Article.

8.03. The following provisions shall govern in connection with the subletting of all or a portion of the Demised Premises:

(a) Tenant shall submit in writing to Landlord (i) the name of the proposed subtenant; (ii) the nature and character of the proposed subtenant's business, and the intended use to be made of the Demised Premises by the proposed subtenant; (iii) the terms and conditions of the proposed sublease; and (iv) such reasonable financial information as Landlord may request regarding the proposed subtenant.

(b) Within fifteen (15) business days of Landlord's receipt of the information described in (a) above, Landlord, at Landlord's election may (i) elect to sublease the Demised Premises directly from Tenant either upon (x) the same terms and conditions offered to the proposed subtenant or, (y) upon the same terms and conditions as set forth in this Lease; or (ii) cancel this Lease as to that portion of the Demised Premises which Tenant desires to sublease, in which event Tenant agrees to surrender all of its right, title, and interest hereunder and Landlord may thereafter enter into a direct Lease with the proposed subtenant or with any other persons as Landlord may desire; or (iii) consent to the subletting on such terms and conditions as established by Landlord, including Landlord's participation in any rentals received by Tenant.

(c) As a condition to Landlord's consent, if given under (b) above, Landlord shall have obtained consent to such proposed subletting by a superior lessor and/or superior mortgagee, provided such superior lessor and/or superior mortgagee requires consent to the subletting.

(d) In connection with any subletting, Tenant shall not offer the Demised Premises, or any part thereof, to any other tenant in the Building or their subsidiaries or affiliates at a rental rate less than the current rental rate for office buildings in the surrounding area.

8.04. Tenant shall remain fully liable for the performance of all Tenant's obligations hereunder notwithstanding any subletting provided for herein (except to Landlord), and without limiting the generality of the foregoing, shall remain fully responsible and liable to Landlord for all acts and omissions of any subtenant of anyone claiming under or through any subtenant which shall be in violation of any of the obligations of this Lease and any such violation shall be deemed to be a violation by Tenant.

8.05. Tenant shall not, without the prior written consent of Landlord, assign this Lease, and the provisions of Section 8.03 with respect to subletting shall equally apply to any assignment of this Lease. Tenant herein named, or any immediate or remote successor in interest of Tenant herein named, shall remain liable jointly and severally (as a primary obligor) with its assignee and all subsequent assignees for the performance of Tenant's obligations hereunder. In the event that Tenant hereunder is a corporation (other than one whose shares, now or in the future, are regularly and publicly traded on a recognized stock exchange, including over the counter, or is a public company or merges with a public company), then any substantial change in the ownership of and/or power to vote the majority of the outstanding capital stock of Tenant,

other than by inheritance or operation of law, shall be deemed an assignment of this Lease and the provisions with respect to assignment shall be applicable.

8.06. Notwithstanding anything to the contrary contained in this Article with respect to assignment or subletting, Landlord's consent to any assignment and/or subletting (i) to any parent, affiliate or wholly-owned subsidiary of Tenant (as defined in Rule 240.12b-2 under the Securities Exchange Act of 1934) or (ii) to any corporation or other entity which succeeds to all or substantially all of the assets and business of Tenant, shall not be unreasonably withheld.

8.07. Tenant agrees that in connection with each separate request for a Landlord's consent to a subletting or assignment, Tenant shall pay to Landlord the sum of \$500.00 representing a reasonable compensation to Landlord for the administration costs of evaluating and responding to the request.

8.08. Tenant further agrees that it shall not place any signs on the windows located in the Demised Premises indicating that all or any portion of the Demised Premises are available for subleasing or assignment.

ARTICLE 9

COMPLIANCE WITH LAWS AND REQUIREMENTS OF PUBLIC AUTHORITIES

9.01. Tenant shall give prompt notice to Landlord of any notice it receives of the violation of any law or requirement of public authority, and at its expense shall comply with all laws and requirements of public authorities which shall, with respect to the Demised Premises or the use and occupation thereof, or the abatement of any nuisance, impose any violation, order or duty on Landlord or Tenant, arising from (i) Tenant's use of the Demised Premises; (ii) the manner of conduct of Tenant's business or operation of its installation, equipment or other property therein; (iii) any cause or condition created by or at the instance of Tenant, other than by Landlord's performance of any work for or on behalf of Tenant; or (iv) the breach of any of Tenant's obligations hereunder. Furthermore, Tenant need not comply with any such law or requirement of public authority so long as Tenant shall be contesting the validity thereof, or the applicability thereof to the Demised Premises, in accordance with Section 9.02.

Nothing contained herein shall be construed to require Tenant to make structural alterations to the Building except to the extent that same are required by reason of Tenant's specific use (other than general office).

9.02. Tenant may, at its expense (and if necessary, in the name of but without expense to Landlord) contest, by appropriate proceedings prosecuted diligently and in good faith, the validity, or applicability to the Demised Premises, of any law or requirement of public authority, and Landlord shall cooperate with Tenant in such proceedings provided that:

(a) Tenant shall defend, indemnify, and hold harmless Landlord against all liability, loss or damage which Landlord shall suffer by reason of such non-compliance or contest, including reasonable attorney's fees and other expenses reasonably incurred by Landlord;

(b) Such non-compliance or contest shall not constitute or result in any violation of any superior lease or superior mortgage, or, if such superior lease and/or superior mortgage shall permit such non-compliance or contest on condition of the taking of action or furnishing of security by Landlord, such action shall be taken and such security shall be furnished at the expense of Tenant; and

(c) Tenant shall keep Landlord advised as to the status of such proceedings.

ARTICLE 10

INSURANCE

10.01. Tenant shall not violate, or permit the violation of, any condition imposed by the all-risk casualty policy issued for the Building and shall not do anything, or permit anything to be kept, in the Demised Premises which would increase the fire or other casualty insurance rate on the Building or the property therein over the rate which would otherwise then be in effect, (unless Tenant pays the resulting increased amount of premium as provided in Section 10.02) or which would result in insurance companies of good standing refusing to insure the Building or any of such property in amounts and at normal rates reasonably satisfactory to Landlord. However, Tenant shall not be subject to any liability or obligation under this Article by reason of the proper use of the Demised Premises for the purposes permitted by Article 2.

10.02. If, by reason of any act or omission on the part of Tenant, the rate of fire insurance with extended all-risk coverage on the Building or equipment or other property of Landlord or other tenants shall be higher than it otherwise would be, Tenant shall reimburse Landlord, on demand, for that part of the premiums for fire insurance and extended all-risk coverage paid by Landlord because of such act or omission on the part of Tenant, which sum shall be deemed to be additional rent and collectible as such.

10.03. In the event that any dispute should arise between Landlord and Tenant concerning insurance rates, a schedule or "make up" of rates for the Building or the Demised Premises, as the case may be, issued by the Fire Insurance Rating Organization of New Jersey or other similar body making rates for fire insurance and extended coverage for the premises concerned, shall be presumptive evidence of the facts therein stated and of the several items and charges in the fire insurance rates with extended coverage then applicable to such premises.

10.04. Tenant shall obtain and keep in full force and effect during the term of this Lease, at its own cost and expense, Comprehensive General Liability Insurance, such insurance to afford protection in an amount of not less than \$1,000,000 for injury or death to any one person, \$3,000,000 for injury or death arising out of any one occurrence, and \$1,000,000 for damage to property, protecting and naming the Landlord and the Tenant as insured against any

and all claims for personal injury, death or property damage occurring in, upon, adjacent, or connected with the Demised Premises and any part thereof. Tenant shall pay all premiums and charges therefor and upon failure to do so Landlord may, but shall not be obligated to, make payments, and in such latter event the Tenant agrees to pay the amount thereof to Landlord on demand and said sum shall be deemed to be additional rent, and in each instance collectible on the first day of any month following the date of notice to Tenant in the same manner as though it were rent originally reserved hereunder, together with interest thereon at the rate of three points in excess of Prime Rate of the First Union. Tenant will use its best efforts to include in such Comprehensive General Liability Insurance policy a provision to the effect that same will be non-cancelable, except upon reasonable advance written notice to Landlord. The original insurance policies or appropriate certificates shall be deposited with Landlord together with any renewals, replacements or endorsements to the end that said insurance shall be in full force and effect for the benefit of the Landlord during the term of this Lease. In the event Tenant shall fail to procure and place such insurance, the Landlord may, but shall not be obligated to, procure and place same, in which event the amount of the premium paid shall be refunded by Tenant to Landlord upon demand and shall in each instance be collectible on the first day of the month or any subsequent month following the date of payment by Landlord, in the same manner as though said sums were additional rent reserved hereunder together with interest thereon at the rate of three points in excess of the Prime Rate of the First Union.

10.05. Landlord and Tenant agree to use their best efforts to include in each of its insurance policies a waiver of the insurer's right of subrogation against the other party or if such waiver shall be unobtainable or unenforceable (a) an express agreement that such policy shall not be invalidated if the insured waives or has waived before the casualty, the right of recovery against any party responsible for a casualty covered by the policy or (b) any other form of permission for the release of the other party. If such waiver, agreement, or permission shall not be or shall cease to be obtainable without additional charge, or at all, the insured party shall so notify the other party after learning thereof. In such a case, if the other party shall agree in writing to pay the insurer's additional charge therefor, such waiver agreement or permission shall, if obtainable, be included in the policy.

10.06. Each party hereby releases the other party with respect to any claim (including a claim for negligence) which it might otherwise have against the other party for loss, damage, or destruction with respect to its property (including rental value or business interruption) occurring during the term of this Lease to the extent to which it is insured under a policy or policies containing a waiver of subrogation or permission to release liability or naming the other party as an additional insured, as provided in Sections 10.04 and 10.05. If notwithstanding the recovery of insurance proceeds by either party for loss, damage or destruction of its property (or rental value or business interruption) the other party is liable to the first party with respect thereto or is obligated under this Lease to make replacement, repair, or restoration or payment, then provided that the first party's right of full recovery under its insurance policies is not thereby prejudiced or otherwise adversely affected, the amount of the net proceeds of the first party's insurance against such loss, damage or destruction shall be offset against the second party's liability to the first party thereof, or shall be made available to the second party to pay for replacement, repair, or restoration, as the case may be.

10.07. The waiver of subrogation or permission for release referred to in Section 10.05 shall extend to the agents of each party and their employees and, in the case of Tenant, shall also extend to all other persons and entities occupying, using or visiting the Demised Premises in accordance with the terms of this Lease, but only if and to the extent that such waiver or permission can be obtained without additional charge (unless such party shall pay such charge). The releases provided for in Section 10.06 shall likewise extend to such agents, employees and other persons and entities, if and to the extent that such waiver or permission is effective as to them. Nothing contained in Section 10.06 shall be deemed to relieve either party of any duty imposed elsewhere in this Lease to repair, restore or rebuild or to nullify any abatement of rents provided for elsewhere in this Lease. Except as otherwise provided in Section 10.04, nothing contained in Sections 10.05 and 10.06 shall be deemed to impose upon either party any duty to procure or maintain any of the kinds of insurance referred to therein or any particular amounts or limits of any such kinds of insurance. However, each party shall advise the other, upon request, from time to time (but not more often than once a year) of all of the policies of insurance it is carrying of any of the kinds referred to in Sections 10.01 and 10.04, and if it shall discontinue any such policy or allow it to lapse, shall notify the other party thereof with reasonable promptness. The insurance policies referred to in Sections 10.05 and 10.06 shall be deemed to include policies procured and maintained by a party for the benefit of its lessor, mortgagee, or pledgee.

ARTICLE 11

RULES AND REGULATIONS

11.01. Tenant and its employees and agent shall faithfully observe and comply with the Rules and Regulations annexed hereto as Exhibit E, and such reasonable changes therein (whether by modification, elimination, or addition) as Landlord at any time or times hereafter may make and communicate in writing to Tenant, which do not unreasonably affect the conduct of Tenant's business in the Demised Premises; provided, however, that in case of any conflict or inconsistency between the provisions of this Lease and any of the Rules and Regulations as originally promulgated or as changed, the provisions of this Lease shall control.

11.02. Nothing contained in this Lease shall be construed to impose upon Landlord any duty or obligation to Tenant to enforce the Rules and Regulations or the terms, covenants, or conditions in any other lease, as against any other tenant and Landlord shall not be liable to Tenant for violation of the same by any other tenant or its employees, agents or visitors. However, Landlord shall not enforce any of the Rules and Regulations in such manner as to discriminate against Tenant or anyone claiming under or through Tenant.

ARTICLE 12

TENANT'S CHANGES

12.01. Tenant shall make no changes, alterations, additions, installations, substitutions, or improvements (hereinafter Collectively called "changes", and, as applied to changes Provided for in this Article, "Tenant's Changes") in and to the Demised Premises without the express prior written consent of Landlord.

All proposed Tenant's Changes shall be submitted to Landlord for written consent at least sixty (60) days prior to the date Tenant intends to commence such changes, such submission to include all plans and specifications for the work to be done, proposed scheduling, and the estimated cost of completion of Tenant's Changes. If Landlord consents to Tenant's Changes, Tenant may commence and diligently prosecute to completion Tenant's Changes, under the direct supervision of Landlord.

Tenant shall pay to Landlord a supervision fee (which shall include the cost of review of the proposed Tenant's Changes) equal to ten percent (10%) of the certified cost of completion of Tenant's Changes. Prior to the commencement of Tenant's Changes, Tenant shall pay to Landlord ten percent (10%) of the estimated cost of completion (the "Estimated Payment") as additional rent. Within fifteen (15) days after completion of Tenant's Changes, Tenant shall furnish Landlord with a statement, certified by an officer or a principal of Tenant to be accurate and true, of the total cost of completion of Tenant's Changes (the "Total Cost"). If such certified statement furnished by Tenant shall indicate that the Estimated Payment exceeded ten percent (10%) of the Total Cost, Landlord shall forthwith either (i) pay the amount of excess directly to Tenant concurrently with the delivery of the certified statement or (ii) permit Tenant to credit the amount of such excess against the subsequent payment of rent due hereunder. If such certified statement furnished by Tenant shall indicate that ten percent (10%) of the Total Cost exceeded Tenant's Estimated Payment, Tenant shall, simultaneously with the delivery to Landlord of the certified statement, pay the amount of such excess to Landlord as additional rent.

12.02. Notwithstanding the provisions of Section 12.01, all proposed Tenant's Changes which shall affect or alter:

- (a) The outside appearance or the strength of the Building or of any of its structural parts; or
- (b) Any part of the Building outside of the Demised Premises; or
- (c) The mechanical, electrical, sanitary and other service systems of the Building, or increase the usage of such systems;

shall be performed only by the Landlord, at a cost to be mutually agreed upon between Landlord and Tenant.

12.03. Tenant, at its expense, shall obtain all necessary governmental permits and certificates for the commencement and prosecution of Tenant's Changes and for final approval thereof upon completion, and shall cause Tenant's Changes to be performed in compliance therewith and with all applicable laws and requirements of public authorities, and with all applicable requirements of insurance bodies, and in good and workmanlike manner, using new materials and equipment at least equal in quality and class to the original installations in the Building. Tenant's Changes shall be performed in such manner as not to unreasonably interfere with or delay and (unless Tenant shall indemnify Landlord therefor to the latter's reasonable satisfaction) as not to impose any additional expense upon Landlord in the construction,

maintenance or operation of the Building. Throughout the performance of Tenant's Changes, Tenant, at its expense, shall carry, or cause to be carried, workmen's compensation insurance in statutory limits and general liability insurance for any occurrence in or about the Building, in which Landlord and its agents shall be named as parties insured in such limits as Landlord may reasonably prescribe, with insurers reasonably satisfactory to Landlord. Tenant shall furnish Landlord with reasonably satisfactory evidence that such insurance is in effect at or before the commencement of Tenant's Changes and, on request, at reasonable intervals thereafter during the continuance of Tenant's Changes. If any of Tenant's Changes shall involve the removal of any fixtures, equipment or other property in the Demised Premises which are not Tenant's Property (as defined in Article 13), such fixtures, equipment or other property shall be promptly replaced, at Tenant's expense, with new fixtures, equipment or other property (as the case may be) of like utility and at least equal value. In addition, unless Landlord shall otherwise expressly consent in writing, the Tenant shall deliver such removed fixtures to Landlord.

12.04. Tenant, at its expense, and with diligence and dispatch, shall procure the cancellation or discharge of all notices of violation arising from or otherwise connected with Tenant's Changes which shall be issued by any public authority having or asserting jurisdiction. Tenant shall defend, indemnify and save harmless Landlord against any and all mechanic's and other liens filed in connection with Tenant's Changes, including the liens of any security interest in, conditional sales of, or chattel mortgages upon, any material, fixtures or articles so installed in and constituting part of the Demised Premises and, against all costs, expenses and liabilities incurred in connection with any such lien, security interest, conditional sale or chattel mortgage or any action or proceeding brought thereon. Tenant, at its expense, shall procure the satisfaction or discharge of all such liens within fifteen (15) days after Landlord makes written demand therefor. However, nothing herein contained shall prevent Tenant from contesting, in good faith and at its own expense, any such notice of violation, provided that Tenant shall comply with the provisions of Section 9.02.

12.05. Tenant agrees that the exercise of its rights pursuant to the provisions of this Article 12 shall not be done in a manner which would create any work stoppage, picketing, labor disruption or dispute or violate Landlord's union contracts affecting the Land and Building, nor interference with the business of Landlord or any tenant or occupant of the Building.

ARTICLE 13

TENANT'S PROPERTY

13.01. All fixtures, equipment, improvements, and appurtenances attached to or built into the Demised Premises at the commencement of or during the term of this Lease, whether or not by or at the expense of Tenant, shall be and remain a part of the Demised Premises, shall be deemed the property of Landlord and shall not be removed by Tenant, except as hereinafter in this Article expressly provided.

13.02. All business and trade fixtures, machinery and equipment, communications equipment and office equipment, whether or not attached to or built into the Demised Premises, which are installed in the Demised Premises by or for the account of Tenant,

without expense to Landlord, and can be removed without permanent structural damage to the Building, and all furniture, furnishings and other articles of movable personal property owned by Tenant and located in the Demised Premises (all of which are sometimes called "Tenant's Property"), shall be and shall remain the property of Tenant and may be removed by it at any time during the term of this Lease; provided that if any of Tenant's Property is removed, Tenant shall repair or pay the cost of repairing any damage to the Demised Premises or to the Building resulting from such removal. Any equipment or other property for which Landlord shall have granted any allowance or credit to Tenant shall not be deemed to have been installed by or for the account of Tenant, without expense to Landlord, and shall not be considered Tenant's Property.

13.03. At or before the Expiration Date, or the date of an earlier termination of this Lease, or as promptly as practicable after such an earlier termination date, Tenant at its expense, shall remove from the Demised Premises all of Tenant's Property, including those items set forth in Section 3.02, except such items thereof as Tenant shall have expressly agreed in writing with Landlord were to remain and to become the property of Landlord, and, if requested by Landlord, all items of work done by or on behalf of Tenant after the Commencement Date shall be removed by Tenant and Tenant shall repair any damage to the Demised Premises or the Building resulting from such removal. If Tenant fails to remove its Property and/or otherwise fails to perform any restoration required of it under this Lease, then Tenant shall be deemed a hold-over Tenant as contemplated in Article 40.

13.04. Any other items of Tenant's Property (except money, securities, and other like valuables) which shall remain in the Demised Premises after the Expiration Date or after a period of fifteen (15) days following an earlier termination date, may, at the option of the Landlord, be deemed to have been abandoned, and in such case either may be retained by Landlord as its property or may be disposed of, without accountability, in such manner as Landlord may see fit, at Tenant's expense.

ARTICLE 14

REPAIRS AND MAINTENANCE

14.01. Tenant shall take good care of the Demised Premises. Tenant, at its expense, shall promptly make all repairs, ordinary or extraordinary, interior or exterior, structural or otherwise in and about the Demised Premises and the Building, as shall be required by reason of (i) the performance of any Tenant's Changes; (ii) the installation, use or operation of Tenant's Property in the Demised Premises by Tenant, its agents or employees; (iii) the moving of Tenant's Property in or out of the Building; or (iv) the misuse or neglect of Tenant or any of its employees, agents, contractors or invitees; but Tenant shall not be responsible, and Landlord shall be responsible, for any of such repairs as are required by reason of Landlord's neglect or other fault in the manner of performing any Tenant's Changes which may be undertaken by Landlord for Tenant's account or are otherwise required by reason of neglect or other fault of Landlord or its employees, agents, or contractors. Except if required by the neglect or other fault of Landlord or its employees, agents, or contractors, Tenant, at its expense, shall replace all scratched, damaged or broken doors or other glass in or about the Demised Premises and shall be responsible for all

repairs, maintenance, and replacement of wall and floor coverings in the Demised Premises and, for the repair and maintenance of all lighting fixtures therein.

14.02. Landlord, subject to the provisions of Section 5.04, shall keep and maintain the Building and its fixtures, appurtenances, systems and facilities serving the Demised Premises, in good working order, condition, and repair and shall make with all due diligence all repairs, structural and otherwise, interior and exterior, as and when needed in or about the Demised Premises, except for those repairs for which Tenant is responsible pursuant to any other provisions of this Lease.

14.03. Landlord shall have no liability to Tenant by reason of any inconvenience, annoyance, interruption, or injury to Tenant's business arising from Landlord's making any repairs or changes which Landlord is required or permitted by this Lease or required by law, to make in or to any portion of the Building or the Demised Premises, or in or to the fixtures, equipment of appurtenances of the Building or the Demised Premises, provided that Landlord shall use due diligence with respect thereto and shall perform such work, except in case of emergency, at a time reasonably convenient to Tenant and otherwise in such a manner as will not materially interfere with Tenant's use of the Demised Premises.

ARTICLE 15

ELECTRICITY

15.01. Landlord shall furnish the electric energy that Tenant shall require in the Demised Premises. Tenant shall pay to Landlord, as additional rent, the costs and charges for all electric energy furnished to Tenant at the Demised Premises. Additional rent for such electric energy shall be calculated and payable in the manner hereinafter set forth.

15.02. Within a reasonable time after the commencement of the term of this Lease, subsequent to Tenant's having taken occupancy of the Demised Premises and having installed and commenced the use of Tenant's electrical equipment, Landlord, at Tenant's sole expense, shall cause a survey to be made by a reputable independent electrical engineer or similar agency of the estimated use of electric energy (other than for Building standard heat and air conditioning as described in Exhibit C) to the Demised Premises, and shall compute the cost thereof for the quantity so determined at prevailing retail rates. Tenant shall pay Landlord the cost of such electric energy, as so calculated, on a monthly basis, as additional rent, together with its payment of fixed rent.

Until such time as Landlord shall complete the aforescribed survey, Tenant shall pay to Landlord, each and every month, as additional rent, for and on account of Tenant's electrical consumption, the sum of \$541.67 to be applied against Tenant's obligations hereunder. Upon completion of the survey, there shall be an adjustment for the period from the Commencement Date through the date that the results of the survey shall be effectuated as shall be required. Landlord shall have the right, at any time, during the term of this Lease, to cause the Demised Premises to be resurveyed. In the event that such resurvey shall indicate increased electrical consumption by Tenant at the Demised Premises, there shall be an adjustment in the

amount paid by Tenant to Landlord for Tenant's electrical consumption in accordance with the resurvey as well as an adjustment retroactive to the date Landlord establishes Tenant's increase in electrical consumption in excess of the consumption established by the prior survey.

Landlord shall submit to Tenant the results of any electrical survey and the same shall be deemed binding upon Tenant unless Tenant shall object to same within ninety (90) days of the date that Landlord shall furnish Tenant with the results of the survey. In the event that Landlord and Tenant cannot agree upon the results of a survey the same shall be submitted to arbitration in accordance with Article 33, provided, however, until such time as the arbitration shall have been concluded, the results of Landlord's survey shall be utilized for the purposes of determining Tenant's electrical consumption with an appropriate adjustment to be made based upon the results of the arbitration.

15.03. Landlord shall not be liable in any way to Tenant for any failure or defect in the supply or character of electric energy furnished to the Demised Premises by reason of any requirement, act, or omission of the public utility serving the Building with electricity or for any other reason. Landlord shall furnish and install all replacement lighting tubes, lamps, bulbs, and ballasts required in the Demised Premises at Tenant's expense.

15.04. Tenant's use of electric energy in the Demised Premises shall not at any time exceed the capacity of any of the electrical conductors and equipment in or otherwise serving the Demised Premises. In order to insure that such capacity is not exceeded and to avert possible adverse effect upon the Building electric service, Tenant shall not, without Landlord's prior written consent in each instance (which shall not be unreasonably withheld), connect any additional fixtures, appliances, or equipment to the Building electrical distribution system or make any alteration or addition to the electric system of the Demised Premises existing on the Commencement Date. Should Landlord grant such consent, all additional risers, HVAC equipment or other electrical equipment required therefor shall be provided by Landlord and the cost of installation and maintenance thereof shall be paid by Tenant upon Landlord's demand. As a condition to granting such consent, Landlord, at Tenant's sole expense, may cause a new survey to be made of the use of electric energy (other than for Building standard heating and air-conditioning as described in Exhibit C) in order to calculate the potential additional electric energy to be made available to Tenant based upon the estimated additional capacity of such additional risers or other equipment. When the amount of such increase is so determined, and the estimated cost thereof is calculated, the amount of monthly additional rent payable pursuant to Section 15.02 hereof shall be adjusted to reflect the additional cost, and shall be payable as therein provided.

15.05. If the public utility rate schedule for the supply of electric current to the Building shall be increased during the term of this Lease, the additional rent payable pursuant to Section 15.02 hereof shall be equitably adjusted to reflect the resulting increase in Landlord's cost of furnishing electric service to the Demised Premises effective as of the date of any increase. Landlord and Tenant agree that the rate charged to Tenant for electricity shall not be greater than the rate Tenant would have paid had the Demised Premises been separately metered.

15.06. Tenant agrees within three (3) months from the Commencement Date to submit to Landlord a list of fixtures and equipment utilizing electric current including, but not limited to, copying machines, computers and word processing equipment and equipment of a similar nature. On the first day of each calendar quarter thereafter, Tenant shall submit to Landlord a statement indicating any substantial changes in the list previously supplied as same may be updated by the required quarterly statements.

ARTICLE 16

HEATING, VENTILATION AND AIR-CONDITIONING

16.01 Landlord, subject to the provisions of Section 5.04, shall maintain and operate the heating, ventilating, and air-conditioning systems (hereinafter called "the systems") and shall furnish heat, ventilating, and air conditioning (hereinafter collectively called "air conditioning service" in the Demised Premises through the systems, in compliance with the performance specifications set forth in Exhibit C, as may be required for comfortable occupancy of the Demised Premises from 8:00 A.M. to 6:00 P.M. Monday through Friday except days observed by the Federal or the state government as legal holidays ("Regular Hours") throughout the year. If Tenant shall require air-conditioning service at any other time (hereinafter called "after hours"), Landlord shall furnish such after hours air-conditioning service upon reasonable advance notice from Tenant, and Tenant shall pay Landlord's then established charges therefor on Landlord's demand.

16.02 Use of the Demised Premises, or any part thereof, in a manner exceeding the design conditions (including occupancy and connected electrical load) specified in Exhibit C for air-conditioning service in the Demised Premises, or rearrangement of partitioning which interferes with normal operation of the air-conditioning in the Demised Premises, may require changes in the air-conditioning system servicing the Demised Premises. Such changes, so occasioned, shall be made by Landlord, at Tenant's expense, as Tenant's Changes pursuant to Article 12.

ARTICLE 17

LANDLORD'S OTHER SERVICES

17.01. Landlord, subject to the provisions of Section 5.04, shall provide public elevator service, passenger and service, by elevators serving the floor on which the Demised Premises are situated during Regular Hours, and shall have at least one passenger elevator subject to call at all other times.

17.02. Landlord, subject to the provisions of Section 5.04, shall cause the Demised Premises, including the exterior and the interior of the windows thereof, to be cleaned. Tenant shall pay to Landlord on demand the costs incurred by Landlord for (a) extra cleaning work in the Demised Premises required because of (i) misuse or neglect on the part of Tenant or its employees or visitors; (ii) use of portions of the Demised Premises for preparation, serving or consumption of food or beverages, data processing, or reproducing operations, private lavatories

or toilets or other special purpose areas requiring greater or more difficult cleaning work than office areas; (iii) unusual quantity of interior glass surfaces; (iv) non-building standard materials or finishes installed by Tenant or at its request; and (b) removal from the Demised Premises and the Building of so much of any refuse and rubbish of Tenant as shall exceed that ordinarily accumulated daily in the routine of business office occupancy. Landlord, its cleaning contractor, and their employees shall have after-hours access to the Demised Premises and the free use of light, power, and water in the Demised Premises as reasonably required for the purpose of cleaning the Demised Premises in accordance with Landlord's obligations hereunder.

17.03. Landlord, subject to the provisions of Section 5.04, shall furnish adequate hot and cold water to each floor of the Building for drinking, lavatory, and cleaning purposes, together with soap, towels, and toilet tissue for each lavatory. If Tenant uses water for any other purpose, Landlord, at Tenant's expense, shall install meters to measure Tenant's consumption of cold water and/or hot water for such other purposes and/or steam, as the case may be. Tenant shall pay for the quantities of cold water and hot water shown on such meters, at Landlord's cost thereof, on the rendition of Landlord's bills therefor.

17.04. Landlord, at its expense, and at Tenant's request, shall insert initial listings on the Building directory of the names of Tenant, and the names of any of their officers and employees, provided that the names so listed shall not take up more than Tenant's proportionate share of the space on the Building directory. All Building directory changes made at Tenant's request after the Tenant's initial listings have been placed on the Building directory shall be made by Landlord at the expense of Tenant, and Tenant agrees to promptly pay to Landlord as additional rent the cost of such changes within ten (10) days after Landlord has submitted an invoice therefor.

17.05. Landlord reserves the right, without any liability to Tenant, to stop service of any of the heating, ventilating, air conditioning, electric, sanitary, elevator, or other Building systems serving the Demised Premises, or the rendition of any of the other services required of Landlord under this Lease, whenever and for so long as may be necessary, by reason of accidents, emergencies, strikes, or the making of repairs or changes which Landlord is required by this Lease or by law to make or in good faith deems necessary, by reason of difficulty in securing proper supplies of fuel, steam, water, electricity, labor or supplies, or by reason of any other cause beyond Landlord's reasonable control.

17.06. Landlord shall make available for Tenant's use Tenant's Proportionate Share of parking spaces in common with other tenants of the Building in the parking area adjacent to the Building.

17.07. The Building and the Demised Premises shall be cleaned in accordance with the Cleaning and Maintenance Schedule set forth on Exhibit D annexed hereto and made a part hereof.

17.08. Tenant acknowledges that as part of the consideration for this Lease, and in order not to interfere with the rights of other tenants or other tenants' quiet enjoyment of the common areas of the Building and otherwise prevent Landlord from performing its services

without causing increases to the cost of such services, Tenant agrees that it shall not permit its employees to congregate in hallways or elevators, shall not permit its employees to create an unsightly condition in or about any passageway from the Building or the common areas or to the parking lot/deck, with regard to smoking, including the disposal of cigarettes, in the courtyard and/or outer areas adjacent to the Building and will otherwise require its employees to act and conduct themselves in the common areas in such a manner as will not disturb other tenants or the use and enjoyment by other tenants of the Building.

ARTICLE 18

ACCESS, CHANGES IN BUILDING FACILITIES, NAME

18.01 All walls, windows, and doors bounding the Demised Premises (including exterior Building walls, core corridor walls and doors, and any core corridor entrance), except the inside surfaces thereof, any terraces or roofs adjacent to the Demised Premises, and any space in or adjacent to the Demised Premises used for shafts, stacks, pipes, conduits, fan room, ducts, electric or other utilities, sinks or other Building facilities, and the use thereof, as well as access thereto through the Demised Premises for the purposes of operation, maintenance, decoration, and repair are reserved to Landlord.

18.02 Tenant shall permit Landlord to install, use, and maintain pipes, ducts, and conduits within the demising walls, bearing columns, and ceilings of the Demised Premises.

18.03. Landlord or Landlord's agent shall have the right upon request (except in emergency under clause (ii) hereof) to enter and/or pass through the Demised Premises or any part thereof, at reasonable times during reasonable hours, (i) to examine the Demised Premises and to show them to the fee owners, lessors of superior leases, holders of superior mortgages, or prospective purchasers, mortgagees, or lessees of the Building as an entirety; and (ii) for the purpose of making such repairs or changes or doing such repainting in or to the Demised Premises or its facilities, as may be provided for by this Lease or as may be mutually agreed upon by the parties or as Landlord may be required to make by law or in order to repair and maintain said structure or its fixtures or facilities. Landlord shall be allowed to take all materials into and upon the Demised Premises that may be required for such repairs, changes, repainting, or maintenance, without liability to Tenant but Landlord shall not unreasonably interfere with Tenant's use of the Demised Premises. Landlord shall also have the right to enter on and/or pass through the Demised Premises, or any part thereof, at such times as such entry shall be required by circumstances of emergency affecting the Demised Premises or the Building.

18.04. During the period of six (6) months prior to the Expiration Date, Landlord may exhibit the Demised Premises to prospective tenants.

18.05. Landlord reserves the right, at any time after completion of the Building, without incurring any liability to Tenant therefor, to make such changes in or to the Building and the fixtures and equipment thereof, as well as in or to the street entrances, halls, passages, elevators, escalators, and stairways thereof, as it may deem necessary or desirable, provided, however, that such changes shall not reduce the size of the Demised Premises.

18.06. Landlord may adopt any name for the Building. Landlord reserves the right to change the name or address of the Building at any time.

ARTICLE 19

NOTICE OF ACCIDENTS

19.01. Tenant shall give notice to Landlord, promptly after Tenant learns thereof, of (i) any accident in or about the Demised Premises for which Landlord might be liable; (ii) all fires in the Demised Premises; (iii) all damage to or defects in the Demised Premises, including the fixtures, equipment, and appurtenances thereof, for the repair of which Landlord might be responsible; and (iv) all damage to or defects in any parts or appurtenances of the Building's sanitary, electrical, heating, ventilating, air-conditioning, elevator, and other systems located in or passing through the Demised Premises or any part thereof.

ARTICLE 20

NON-LIABILITY AND INDEMNIFICATION

20.01. Neither Landlord nor any agent or employee of Landlord shall be liable to Tenant for any injury or damage to Tenant or to any other person or for any damage to, or loss (by theft or otherwise) of, any property of Tenant or of any other person, irrespective of the cause of such injury, damage, or loss, unless caused by or due to the negligence of Landlord, its agents, or employees without contributory negligence on the part of Tenant.

20.2. Tenant shall indemnify and save harmless Landlord and its agents against and from (a) any and all claims (i) arising from (x) the conduct or management of the Demised Premises or of any business therein, or (y) any work or thing whatsoever done, or any condition created (other than by Landlord for Landlord's or Tenant's account) in or about the Demised Premises during the term of this Lease or during the period of time, if any, prior to the Commencement Date that Tenant may have been given access to the Demised Premises, or (ii) arising from any negligent or otherwise wrongful act or omission of Tenant or any of its subtenants, invitees or licensees or its or their employees, agents, or contractors, and (b) all costs, expenses, and liabilities incurred in or in connection with each such claim or action or proceeding brought thereon. In case any action or proceeding be brought against Landlord by reason of any such claim, Tenant, upon notice from Landlord, shall resist and defend such action or proceeding.

20.3. Except as otherwise expressly provided in this Lease, this Lease and the obligations of Tenant hereunder shall be in no wise affected, impaired or excused because Landlord is unable to fulfill, or is delayed in fulfilling, any of its obligations under this Lease by reason of strike, other labor trouble, governmental pre-emption or priorities or other controls in connection with a national or other public emergency or shortages of fuel supplies or labor resulting therefrom, or other like cause beyond Landlord's reasonable control.

ARTICLE 21

DESTRUCTION OR DAMAGE

21.01. If the Building or the Demised Premises shall be partially or totally damaged or destroyed by fire or other cause, then whether or not the damage or destruction shall have resulted from the fault or neglect of Tenant, or its employees, agents or visitors (and if this Lease shall not have been terminated as in this Article hereinafter provided), Landlord shall repair the damage and restore and rebuild the Building and/or the Demised Premises, at its expense, with reasonable dispatch after notice to it of the damage or destruction; provided, however, that Landlord shall not be required to repair or replace any of the Tenant's Property.

21.02. If the Building or the Demised Premises shall be partially damaged or partially destroyed by fire or other cause not attributable to the fault or negligence of Tenant, its agents, or employees, the rents payable hereunder shall be abated to the extent that the Demised Premises shall have been rendered untenable and for the period from the date of such damage or destruction to the date the damage shall be repaired or restored; provided, however, if the damage shall be attributable to the fault or negligence of Tenant, its agents or employees, then rent shall continue but shall be reduced by any amounts received by Landlord pursuant to Landlord's coverage for business interruption and/or rent insurance attributable to the Demised Premises. If the Demised Premises or a major part thereof shall be totally (which shall be deemed to include substantially totally) damaged or destroyed or rendered completely (which shall be deemed to include substantially completely) untenable on account of fire or other cause, the rents shall abate as of the date of the damage or destruction and until Landlord shall repair, restore, and rebuild the Building and the Demised Premises, provided, however, that should Tenant reoccupy a portion of the Demised Premises during the period of restoration work is taking place and prior to the date that the same are made completely tenable, rents allocable to such portion shall be payable by Tenant from the date of such occupancy.

21.03. If the Building or the Demised Premises shall be totally damaged or destroyed by fire or other cause, or if the Building shall be so damaged or destroyed by fire or other cause (whether or not the Demised Premises are damaged or destroyed) as to require a reasonably estimated expenditure of more than twenty-five percent (25%) of the full insurable value of the Building immediately prior to the casualty then in either such case Landlord may terminate this Lease by giving Tenant notice to such effect within one hundred eighty (180) days after the date of the casualty. In case of any damage or destruction mentioned in this Article, Tenant may terminate the Lease by notice to Landlord, if Landlord has not completed the making of the required repairs and restored and rebuilt the Building and the Demised Premises within twelve (12) months from the date of such damage or destruction, or within such period after such date (not exceeding six (6) months) as shall equal the aggregate period Landlord may have been delayed in doing so by adjustment of insurance, labor trouble, governmental controls, act of God, or any other cause beyond Landlord's reasonable control.

21.04. No damages, compensation, or claim shall be payable by Landlord for inconvenience, loss of business, or annoyance arising from any repair or restoration of any portion of the Demised Premises or of the Building pursuant to this Article. Landlord shall use its best

efforts to effect such repair or restoration promptly and in such manner as not unreasonably to interfere with Tenant's use and occupancy during such time that Tenant is able to use the Demised Premises during Landlord's restoration.

21.05 Notwithstanding any of the foregoing provisions of this Article, if Landlord or the lessor of any superior lease or the holder of any superior mortgage shall be unable to collect all of the insurance proceeds (including rent insurance proceeds) applicable to damage or destruction of the Demised Premises or the Building by fire or other cause, by reason of some action or inaction on the part of Tenant or any of its employees, agents or contractors in connection with the processing of any claim, then, without prejudice to any other remedies which may be available against Tenant, there shall be no abatement of Tenant's rents.

21.06 Landlord will not carry insurance of any kind on Tenant's Property, and, except as provided by law or by reason of its fault or its breach of any of its obligations hereunder, shall not be obligated to repair any damage thereto or replace the same; to the extent that Tenant shall maintain insurance on Tenant's Property, Landlord shall not be obligated to repair any damage thereto or replace the same.

21.07. The provisions of this Article shall be considered an express agreement governing any case of damage or destruction of the Demised Premises by fire or other casualty, and any law of the State of New Jersey providing for such a contingency in the absence of an express agreement, and any other law of like import, now or hereafter in force, shall have no application in such case.

21.08. If the Demised Premises and/or access thereto become partially or totally damaged or destroyed by any casualty not insured against, then Landlord shall have the right to terminate this Lease upon giving the Tenant thirty (30) days notice and upon the expiration of said thirty (30) day notice period this Lease shall terminate as if such termination date were the Expiration Date.

ARTICLE 22

EMINENT DOMAIN

22.01. If the whole of the Building shall be lawfully taken by condemnation or in any other manner for any public or quasi-public use of purpose, this Lease and the term and estate hereby granted shall forthwith terminate as of the date of vesting of title on such taking (which date is herein after also referred to as the "date of the taking"), and the rents shall be prorated and adjusted as of such date.

22.02. If any part of the Building shall be so taken, this Lease shall be unaffected by such taking, except that Tenant may elect to terminate this Lease in the event of a partial taking, if the area of the Demised Premises shall not be reasonably sufficient for Tenant to continue feasible operation of its business. Tenant shall give notice of such election to Landlord not later than thirty (30) days after the date of such taking. Upon the giving of such notice to Landlord, this Lease shall terminate on the date of service of notice and the rents apportioned to

the part of the Demised Premises so taken shall be prorated and adjusted as of the date of the taking and the rents apportioned to the remainder of the Demised Premises shall be prorated and adjusted as of such termination date. Upon such partial taking and this Lease continuing in force as to any part of the Demised Premises, the rents apportioned to the part taken shall be prorated and adjusted as of the date of taking and from such date the fixed rent shall be reduced to the amount apportioned to the remainder of the Demised Premises and additional rent shall be payable pursuant to Article 5 according to the rentable area remaining.

22.03. Except as specifically set forth in Section 22.04. hereof, Landlord shall be entitled to receive the entire award in any proceeding with respect to any taking provided for in this Article without deduction therefrom for any estate vested in Tenant by this Lease, and Tenant shall receive no part of such award. Tenant hereby expressly assigns to Landlord all of its right, title, and interest in or to every such award.

22.04. If the temporary use or occupancy of all or any part of the Demised Premises shall be lawfully taken by condemnation or in any other manner for any public or quasi-public use or purpose during the term of this Lease, Tenant shall be entitled, except as hereinafter set forth, to receive any award which does not serve to diminish Landlord's award in any respect and, if so awarded, for the taking of Tenant's Property and for moving expenses, and Landlord shall be entitled to receive that portion which represents reimbursement for the cost of restoration of the Demised Premises. This Lease shall be and remain unaffected by such taking and Tenant shall remain responsible for all of its obligations hereunder insofar as such obligations are not affected by such taking and shall continue to pay in full the fixed rent and additional rent when due. If the period of temporary use or occupancy of the Demised Premises (or a part thereof) shall be divided between Landlord and Tenant so that Tenant shall receive so much thereof as represents the period prior to the Expiration Date and Landlord shall receive so much thereof as represents the period subsequent to the Expiration Date. All moneys received by Tenant as, or as part of an award for temporary use and occupancy for a period beyond the date to which the rents hereunder have been paid by Tenant shall be received, held, and applied by Tenant as a trust fund for payment of the rents falling due hereunder.

22.05. In the event of any taking of less than the whole of the Building which does not result in a termination of this Lease, or in the event of a taking for a temporary use or occupancy of all or any part of the Demised Premises which does not extend beyond the Expiration Date, Landlord, at its expense, shall proceed with reasonable diligence to repair, alter, and restore the remaining parts of the Building and the Demised Premises to substantially their former condition to the extent that the same may be feasible and so as to constitute a complete and tenantable Building and Demised Premises provided that Landlord's liability under this Section 22.05 shall be limited to the net amount (after deducting all costs and expenses, including but not limited to, legal expenses incurred in connection with the eminent domain proceeding) received by Landlord as an award arising out of such taking. If such taking occurs within the last: three (3) years of the term of this Lease, Landlord shall have the right to terminate this Lease by giving the Tenant written notice to such effect within ninety (90) days after such taking, and this Lease shall then expire on that effective date stated in the notice as if that were the Expiration Date, but the fixed rent and the additional rent shall be prorated and adjusted as of the date of such taking.

22.06. Should any part of the Demised Premises be taken to effect compliance with any law or requirement of public authority other than in the manner hereinabove provided in this Article then, (i) if such compliance is the obligation of Tenant under this Lease, Tenant shall not be entitled to any diminution or abatement of rent or other compensation from Landlord therefor, but (ii) if such compliance is the obligation of Landlord under this Lease, the fixed rent hereunder shall be reduced and additional rents under Article 5 shall be adjusted in the same manner as is provided in Section 22.02 according to the reduction in rentable area of the Demised Premises resulting from such taking.

22.07. Any dispute which may arise between the parties with respect to the meaning or application of any of the provisions of this Article shall be determined by arbitration in the manner provided in Article 33.

ARTICLE 23

SURRENDER

23.01. On the last day of the term of this Lease, or upon any earlier termination of this Lease, or upon any re-entry by Landlord upon the Demised Premises, Tenant shall quit and surrender the Demised Premises to Landlord in good order, condition, and repair, except for ordinary wear and tear and such damage or destructions as Landlord is required to repair or restore under this Lease, and Tenant shall remove all of Tenant's Property therefrom except as otherwise expressly provided in this Lease. Landlord reserves the right to require Tenant to remove all items installed by, for or on behalf of Tenant. At or before the Expiration Date of the Lease, along with any other restoration required by Tenant pursuant to the Lease or any Tenant Change, Tenant agrees to perform the following restoration to the Demised Premises:

Tenant shall remove from the Demised Premises all equipment comprising Tenant's Voice, Data and Security Systems, including associated outlets, wires, wiring trays and other equipment, materials and facilities, whether located in the ceiling, floor and/or walls which in any way relates, pertains to, constitutes or is connected with Tenant's Voice, Data and/or Security Systems and regardless of whether Landlord or Tenant installed and/or paid for the installation of such systems.

If Tenant fails to perform any restoration required of it under this Lease on or before the last day of the term of this Lease or upon any earlier termination, Tenant shall be deemed a hold-over Tenant under Article 40 of this Lease until such time as Tenant has completed such restoration.

ARTICLE 24

CONDITIONS OF LIMITATION

24.01. This Lease and the term and estate hereby granted are subject to the limitation that whenever Tenant shall make an assignment of the property of Tenant for the benefit of creditors, or shall file a voluntary petition under any bankruptcy or insolvency law, or

an involuntary petition alleging an act of bankruptcy or insolvency shall be filed against Tenant under any bankruptcy or insolvency law, or whenever a petition shall be filed by or against Tenant under the reorganization provisions of the United States Bankruptcy Act or under the provisions of any law of like imports or whenever a petition shall be filed by Tenant under the arrangement provisions of any law of like import, whenever a permanent receiver of Tenant or of or for the property of Tenant shall be appointed, then Landlord, (a) at any time of receipt of notice of the occurrence of any such event, or (b) if such event occurs without the acquiescence of Tenant, at any time after the event continues for thirty (30) days, Landlord may give Tenant a notice of intention to end the term of this Lease at the expiration of five (5) days from the date of service of such notice of intention, and upon the expiration of said five (5) day period this Lease and the term and estate hereby granted, whether or not the term shall theretofore have commenced, shall terminate with the same effect as if that day were the Expiration Date, but Tenant shall remain liable for damages as provided in Article 26.

24.02. This Lease and the term and estate hereby granted are subject to the further limitation that:

(a) Whenever Tenant shall default in the payment of installment of fixed rent, or in the payment of any additional rent or any other charge payable by Tenant to Landlord, or any day upon which the same ought to be paid, and such default shall continue for five (5) days after written notice thereof; or

(b) Whenever Tenant shall do or permit anything to be done, whether by action or inaction, contrary to any of Tenant's obligations hereunder, and if such situation shall continue and shall not be remedied by Tenant within thirty (30) days after Landlord shall have given to Tenant a written notice specifying the same, or, in the case of a happening or default which cannot with due diligence be cured within a period of thirty (30) days and the continuance of which for the period required for cure will not subject Landlord to risk of criminal liability or termination of any superior Lease or foreclosure of any superior mortgage if Tenant shall not, (i) within said thirty (30) day period advise Landlord of Tenant's intention to duly institute all steps necessary to remedy such situation; (ii) duly institute within said thirty (30) day period, and thereafter diligently prosecute to completion all steps necessary to remedy the same; (iii) complete such remedy within such time after the date of giving of said notice to Landlord as shall reasonably be necessary; or

(c) Whenever any event shall occur or any contingency shall arise whereby this Lease or the estate hereby granted or the unexpired balance of the term hereof would, by operation of law or otherwise, devolve upon or pass to any person, firm, or corporation other than Tenant, except as expressly permitted by Article 8; or

(d) Whenever Tenant shall abandon the Demised Premises (unless as a result of a casualty), or

(e) If Tenant shall default in the timely payment of rent or additional rent and any such default shall continue to be repeated for two (2) consecutive months or for a total of four (4) months in any period of twelve (12) months, or more than three (3) times in any

six (6) month period, then, notwithstanding that such defaults shall have each been cured within the applicable period, any similar default shall be deemed to be deliberate and Landlord may thereafter serve a notice of termination upon Tenant without affording to Tenant opportunity to cure such default;

then, and in any of the foregoing cases, this Lease and the term and estate hereby granted, whether or not the term shall theretofore have commenced, shall, if the Landlord so elects, terminate upon ten (10) days written notice by Landlord to Tenant of Landlord's election to terminate the Lease and the term hereof shall expire and come end on the date fixed in such notice, with the same effect as if that day were the Expiration Date, but Tenant shall remain liable for the rent and additional rent which subsequently accrues and for damages as provided in Article 26.

ARTICLE 25

RE-ENTRY BY LANDLORD

25.01. If Tenant shall default in the payment of any installment of fixed rent, or of any installment of additional rent, on any date upon which the same ought to be paid and if such default shall continue for five (5) days after written notice thereof, or if this Lease shall expire as provided in Article 24, Landlord or Landlord's agents and employees may immediately or at any time thereafter re-enter the Demised Premises, or any part thereof, in the name of the whole, either by summary dispossession proceedings or by any suitable action or proceeding at law, or by force or otherwise, without being liable to indictment, prosecution or damages therefor, and may repossess the same, and may remove any persons therefrom, to the end that Landlord may have, hold, and enjoy the Demised Premises again as and of its first estate and interest therein. The word "re-enter", as herein used, is not restricted to its technical legal meaning. In the event of any termination of this Lease under the provisions of Article 24 or if Landlord shall re-enter the Demised Premises under the provisions of this Article or in the event of the termination of this Lease, or of re-entry, by or under any summary dispossession or other proceeding or action or any provision of law by reason of default hereunder on the part of Tenant, Tenant shall thereupon pay to Landlord the fixed rent and additional rent payable by Tenant to Landlord up to the time of such termination of this Lease, or of such recovery of possession or the Demised Premises by Landlord, as the case may be, and shall also pay to Landlord damages as provided in Article 26.

25.02. In the event of a breach or threatened breach by Landlord or Tenant of any of their respective obligations under this Lease, either Landlord or Tenant, as the case may be, shall also have the right of injunction. The special remedies hereunder are cumulative and are not intended to be exclusive of any other remedies or means of redress to which the parties may lawfully be entitled at any time.

25.03. If this Lease shall terminate under the provisions of Article 24, or if Landlord shall re-enter the Demised Premises under the provisions of this Article, or in the event of any termination of this Lease, or of re-entry, by or under any summary dispossession or other proceeding or action or any provision of law by reason of default hereunder on the part of Tenant, Landlord shall be entitled to retain all moneys, if any, paid by Tenant to Landlord, whether as

advance rent, security, or otherwise, but such moneys shall be credited by Landlord against any fixed rent or additional rent due from Tenant at the time of such termination or re-entry or, at Landlord's option, against any damages payable by Tenant under Article 26 or pursuant to law.

ARTICLE 26

DAMAGES

26.01. If this Lease is terminated under the provisions of Article 24, or if Landlord shall re-enter the Demised Premises under the provisions of Article 25, or in the event of the termination of this Lease, or of re-entry, by or under any summary dispossession or other proceeding or action of any provision of law by reason of default hereunder on the part of Tenant, Tenant shall pay to Landlord as damages, at the election of Landlord, either

(a) A sum which at the time of such termination of this Lease or at the time of any such re-entry by Landlord, as the case may be, represents the then value of the excess, if any, of (i) the aggregate of the fixed rent and the additional rent payable hereunder which would have been payable by Tenant (conclusively presuming the additional rent to be the same as was payable for the year immediately preceding such termination) for the period commencing with such earlier termination of this Lease or the date of any such re-entry, as the case may be, and ending with the Expiration Date, had this Lease not so terminated or had Landlord not so re-entered the Demised Premises, over (ii) the aggregate rental value of the Demised Premises for the same period, or

(b) Sums equal to the fixed rent and the additional rent (as above presumed) payable hereunder which would have been payable by Tenant had this Lease not so terminated, or had Landlord not so re-entered the Demised Premises, payable upon the due dates therefor specified herein following such termination or such re-entry and until the Expiration Date, provided, however, that if Landlord shall relet the Demised Premises during said period, Landlord shall credit Tenant with the net rents received by Landlord from such reletting, such net rents to be determined by first deducting from the gross rents as and when received by Landlord from such reletting, the expenses incurred or paid by Landlord in terminating this Lease or in re-entering the Demised Premises and in securing possession thereof, as well as the expenses of reletting, including altering and preparing the Demised Premises for new tenants, brokers' commissions, and all other expenses properly chargeable against the Demised Premises and the rental therefrom; it being understood that any such reletting may be for a period shorter or longer than the remaining term of this Lease; but in no event shall Tenant be entitled to receive any excess of such net rents over the sums payable by Tenant to Landlord hereunder, nor shall Tenant be entitled in any suit for the collection of damages pursuant to this Subsection to a credit in respect of any net rents from a reletting, except to the extent that such net rents are actually received by Landlord. If the Demised Premises or any part thereof should be relet in combination with other space, then proper apportionment on a square foot basis shall be made of the rent received from such reletting and of the expenses of reletting.

If the Demised Premises or any part thereof to be relet by Landlord for the unexpired portion of the term of this Lease, or any part thereof, before presentation of proof

of such damages to any court, commission or tribunal, the amount of rent reserved upon such reletting shall, prima facie, be the fair and reasonable rental value for the Demised Premises, or part thereof, so relet during the term of the reletting.

26.02. Suit or suits for the recovery of such damages, or any installments thereof, may be brought by Landlord from time to time at its election, and nothing contained herein shall be deemed to require Landlord to postpone suit until the date when the term of this Lease would have expired if it had not been so terminated under the provisions of Article 24, or under any provision of law, or had Landlord not re-entered the Demised Premises. Nothing herein contained shall be construed to limit or preclude recovery by Landlord against Tenant of any sums or damages to which, in addition to the damages particularly provided above, Landlord may lawfully be entitled by reason of any default hereunder on the part of Tenant. Nothing herein contained shall be construed to limit or prejudice the right of Landlord to seek and obtain as liquidated damages by reason of the termination of this Lease or re-entry on the Demised Premises for the default of Tenant under this Lease, an amount equal to the maximum allowed by any statute or rule of law in effect at the time when, and governing the proceedings in which, such damages are to be proved whether or not such amount be greater, equal to, or less than any of the sums referred to in Section 26.01.

26.03. In addition to the foregoing and without regard to whether this Lease is terminated, Tenant shall pay to Landlord upon demand, all costs and expenses incurred by Landlord, including reasonable attorney's fees, with respect to any lawsuit instituted or defended or any action taken by Landlord to enforce all or any of the provisions of this Lease.

ARTICLE 27

WAIVERS

27.01. Tenant, for Tenant, and on behalf of any and all persons claiming through or under Tenant, including creditors of all kinds, does hereby waive and surrender all right and privilege which they or any of them might have under or by reason of any present or future law, to redeem the Demised Premises or to have a continuance of this Lease for the term hereby demised after being dispossessed or ejected therefrom by process of law or under the terms of this Lease or after the termination of this Lease as herein provided.

27.02. In the event that Tenant is in arrears in payment of fixed rent or additional rent hereunder, Tenant waives Tenant's right, if any, to designate the items against which any payments made by Tenant are to be credited, and Tenant agrees that Landlord may apply any payments made by Tenant to any items it sees fit, irrespective of and notwithstanding any designation or request by Tenant as to the items against which any such payments shall be credited.

27.03. Landlord and Tenant hereby waive trial by jury in any action, proceeding or counterclaim brought by either against the other on any matter whatsoever arising out of or in any way connected with this Lease, the relationship of Landlord and Tenant, Tenant's use or

occupancy of the Demised Premises, including any claim of injury or damage, or any emergency or other statutory remedy with respect thereto.

27.04. The provisions in Articles 16 and 17 shall be considered express agreements governing the services to be furnished by Landlord, and Tenant agrees that any laws and/or requirements of public authorities, now or hereafter in force, shall have no application in connection with any enlargement of Landlord's obligations with respect to such services.

ARTICLE 28

NO OTHER WAIVERS OR MODIFICATIONS

28.01. The failure of either party to insist in any one or more instances upon the strict performance of any one or more of the obligations of this Lease, or to exercise any election herein contained, shall not be construed as a waiver or relinquishment for the future of the performance of such one or more obligations of this Lease or of the right to exercise such election, but the same shall continue and remain in full force and effect with respect to any subsequent breach, act, or omission. No executory agreement hereafter made between Landlord and Tenant shall be effective to change, modify, waive, release, discharge, terminate or effect an abandonment of this Lease, in whole or in part, unless such executory agreement is in writing, refers expressly to this Lease and is signed by the party against whom enforcement of the change, modification, waiver, release, discharge, or termination of effectuation of the abandonment is sought.

28.02. Without limiting Section 28.01, the following provisions shall also apply:

(a) No agreement to accept a surrender of all or any part of the Demised Premises shall be valid unless in writing and signed by Landlord. The delivery of keys to an employee of Landlord or of its agent shall not operate as a termination of this Lease or a surrender of the Demised Premises. If Tenant shall at any time request Landlord to sublet the Demised Premises for Tenant's account, Landlord or its agent is authorized to receive said keys for such purposes without releasing Tenant from any of its obligations under this Lease, and Tenant hereby releases Landlord from any liability for loss or damage to any of Tenant's property in connection with such subletting.

(b) The receipt by Landlord of rent with knowledge of breach of any obligation of this Lease shall not be deemed a waiver of such breach.

(c) No payment by Tenant or receipt by Landlord of a lesser amount than the correct fixed rent or additional rent due hereunder shall be deemed to be other than a payment on account, nor shall any endorsement or statement on any check or any letter accompanying any check or payment be deemed an accord and satisfaction, and Landlord may accept such check or payment without prejudice to Landlord's right to recover the balance or pursue any other remedy in this Lease or at law provided.

ARTICLE 29

CURING TENANT'S DEFAULTS

29.01. If Tenant shall default in the performance of any of Tenant's obligations under this Lease, Landlord, without thereby waiving such default, may (but shall not be obligated to) perform the same for the account and at the expense of Tenant, without notice, in a case of emergency, and in any other case, only if such default continues after the expiration of (i) ten (10) days from the date Landlord gives Tenant notice of intention so to do, or (ii) the applicable grace period provided in Section 24.02 or elsewhere in this Lease for cure of such default, whichever occurs later.

29.02. Bills, invoices and purchase orders for any and all costs, charges, and expenses incurred by Landlord in connection with any such performance by it for the account of Tenant, including reasonable counsel fees, involved in collecting or endeavoring to collect the fixed rent or additional rent or any part thereof, or enforcing or endeavoring to enforce any rights against Tenant, under or in connection with this Lease, or pursuant to law, including any such cost, expense, and disbursement involved in instituting and prosecuting summary proceedings, may be sent by Landlord to Tenant monthly, or immediately, at Landlord's option, and, shall be due and payable in accordance with the terms of such bills.

ARTICLE 30

BROKER

30.01. Tenant covenants, warrants, and represents that there was no broker except JACOBSON, GOLDFARB & TANZMAN ASSOCIATES, ("Broker") instrumental in consummating this Lease and that no conversations or negotiations were had with any broker except Broker concerning the renting of the Demised Premises. Tenant agrees to hold Landlord harmless against any claims for a brokerage commission arising out of any conversations or negotiations had by Tenant with any broker except Broker. Landlord agrees to pay Broker pursuant to a separate agreement.

ARTICLE 31

NOTICES

31.01. Any notice, statement, demand, or other communications required or permitted to be given, rendered, or made by either party to the other, pursuant to this Lease or pursuant to any applicable law or requirement of public authority, shall be in writing (whether or not so stated elsewhere in this Lease) and shall be deemed to have been properly given, rendered or made, if sent by registered or certified mail, return receipt requested, addressed to the other party at the address hereinabove set forth (except that after the Commencement Date, Tenant's address, unless Tenant shall give notice to the contrary, shall be the Building) and shall be deemed to have been given, rendered, or made on the date following the date of mailing. Notice may also

be given by facsimile transmittal over overnight mail. If such notice is given by facsimile transmittal, it shall be deemed received the day it was sent and overnight mail shall be deemed received the day after it was sent. Either party may, by notice as aforesaid, designate a different address or addresses for notices, statements, demands, or other communications intended for it. In the event of the cessation of any mail delivery for any reason, personal delivery shall be substituted for the aforescribed method of serving notices.

ARTICLE 32

ESTOPPEL CERTIFICATE

32.01. Tenant agrees, when requested by Landlord, to execute and deliver to Landlord a statement certifying that this Lease is unmodified and in full force and effect (or if there have been modifications, that the same is in full force and effect as modified and stating the modifications), certifying the dates to which the fixed rent and additional rent have been paid, whether any dispute exists with respect thereto and stating whether or not, to Tenant's best knowledge, Landlord is in default in performance of any of its obligations under this Lease, and, if so, specifying each such default of which Tenant may have knowledge, it being intended that any such statement delivered pursuant hereto may be relied upon by others. Such statement shall be served upon Landlord by Tenant within ten (10) days of Landlord's request. If Tenant fails to deliver such notice, Landlord shall be deemed appointed as Tenant's attorney-in-fact to prepare and deliver such notice on behalf of Tenant, and Tenant shall be deemed bound thereby upon Landlord's furnishing a copy of the notice to Tenant.

ARTICLE 33

ARBITRATION

33.01. The parties hereto shall not be deemed to have agreed to determination of any dispute arising out of this Lease by arbitration unless determination in such manner shall have been specifically provided for in this Lease.

33.02. The party desiring arbitration shall give notice to that effect to the other party and shall in such notice appoint a person as arbitrator on its behalf. Within ten (10) days, the other party by notice to the original party shall appoint a second person as arbitrator on its behalf. The arbitrators thus appointed shall appoint a third person, and such three arbitrators shall as promptly as possible determine such matter, provided, however that:

(a) If the second arbitrator shall not have been appointed as aforesaid, the first arbitrator shall proceed to determine such matter; and

(b) If the two arbitrators appointed by the parties shall be unable to agree, within ten (10) days after the appointment of the second arbitrator, upon the appointment of a third arbitrator, they shall give written notice to the parties of such failure to agree, and, if the parties fail to agree upon the selection of such third arbitrator within ten (10) days after the arbitrators appointed by the parties give notice as aforesaid, then within five (5) days thereafter

either of the parties upon notice to the other party may request such appointment by the American Arbitration Association (or any organization successor thereto), or in its absence, refusal, failure, or inability to act, may apply for a court appointment of such arbitrator.

33.03. Each arbitrator shall be a fit and impartial person who shall have had at least five years' experience in a calling connected with the matter of dispute.

33.04. The arbitration shall be conducted, to the extent consistent with this Article, in accordance with the then prevailing rules of the American Arbitration Association (or any organization successor thereto). The arbitrators shall render their decision and award, upon the concurrence of at least two of their number, within thirty (30) days after the appointment of the third arbitrator. Such decision and award shall be in writing and shall be final and conclusive on the parties, and counterpart copies thereof shall be delivered to each of the parties. In rendering such decision and award, the arbitrators shall not add to, subtract from, or otherwise modify the provisions of this Lease. Judgment may be had on the decision and award of the arbitrator(s) so rendered in any court of competent jurisdiction.

33.05. Each party shall pay the fees and expenses of the one of the two original arbitrators appointed by or for such party and the fees and expenses of the third arbitrator and all other expenses of the arbitration (other than the fees and disbursement of attorneys or witnesses for each party) shall be borne by the parties equally.

33.06. Notwithstanding the provisions of this Article, if any delay in complying with any requirements of this Lease by Tenant might subject Landlord to any fine or penalty, or to prosecution for a crime, or if it would constitute a default by Landlord under any mortgage, Landlord may exercise its right under Article 29, to remedy such default and in such event the sole question to be determined by the arbitrators under this Article, shall be whether Tenant is liable for Landlord's cost and expenses of curing such default.

ARTICLE 34

NO OTHER REPRESENTATIONS, CONSTRUCTION, GOVERNING LAW

34.01. Tenant expressly acknowledges and agrees that Landlord has not made and is not making, and Tenant, in executing and delivering this Lease, is not relying upon, any warranties, representations, promises or statements, except to the extent that the same are expressly set forth in this Lease. It is understood and agreed that all understandings and agreements heretofore had between the parties are merged in the Lease, which alone fully and completely express their agreements and that the same are entered into after full investigation, neither party relying upon any statement or representation not embodied in the Lease made by the other.

34.02. If any of the provisions of this Lease, or the application thereof to any person or circumstances, shall, to any extent, be invalid or unenforceable, the remainder of this Lease, or the application of such provision or provisions to persons or circumstances other than

those as to whom or which it is held invalid or unenforceable, shall not be affected thereby, and every provision of this Lease shall be valid and enforceable to the fullest extent permitted by law.

34.03. This Lease shall be governed in all respects by the laws of the State of New Jersey.

ARTICLE 35

SECURITY

35.01. Tenant shall deposit with Landlord the sum of \$10,725.00 upon the execution of this Lease. Said deposit (sometimes referred to as the "Security Deposit") shall be held by Landlord as security for the faithful performance by Tenant of all the terms of the Lease by said Tenant to be observed and performed. The Security Deposit shall not and may not be mortgaged, assigned, transferred, or encumbered by Tenant, without the written consent of Landlord, and any such act on the part of Tenant shall be without force and effect and shall not be binding upon Landlord. If any of the fixed or additional rent herein reserved or any other sum payable by Tenant to Landlord shall be overdue and unpaid, or if Landlord makes payment on behalf of Tenant, or if Tenant shall fail to perform any of the terms, covenants, and conditions of the Lease, then Landlord may, at its option and without prejudice to any other remedy which Landlord may have on account thereof, appropriate and apply the entire Security Deposit or so much thereof as may be necessary to compensate Landlord toward the payment of fixed or additional rent and any loss or damage sustained by Landlord due to such breach on the part of Tenant, plus expenses; and Tenant shall forthwith upon demand restore the Security Deposit to the original sum deposited. The issuance of a warrant and/or the re-entering of the Demised Premises by Landlord for any default on the part of Tenant or for any other reason prior to the expiration of the term shall not be deemed such a termination of the Lease as to entitle Tenant to the recovery of the Security Deposit. If Tenant complies with all of the terms, covenants, and conditions of the Lease and pays all of the fixed and additional rent and all other sums payable by Tenant to Landlord as they fall due, the Security Deposit shall be promptly returned in full to Tenant after the expiration of the term of the Lease and Tenant's satisfaction of all its obligations accruing prior to the Lease expiration date. In the event of bankruptcy or other creditor-debtor proceedings against Tenant, the Security Deposit and all other securities shall be deemed to be applied first to the payment of fixed and additional rent and other charges due Landlord for all periods prior to the filing of such proceedings. In the event of sale by Landlord of the Building, Landlord may deliver the then balance of the Security Deposit to the transferee of Landlord's interest in the Demised Premises and Landlord shall thereupon be discharged from any further liability with respect to the Security Deposit and this provision shall also apply to any subsequent transferees. No holder of a superior mortgage or a lessor's interest in a superior lease to which the Lease is subordinate shall be responsible in connection with the Security Deposit, by way of credit or payment of any fixed or additional rent, or otherwise, unless such mortgagee or lessor actually shall have received the entire Security Deposit.

ARTICLE 36

PARTIES BOUND

36.01. The obligation of this Lease shall bind and benefit the successors and assigns of the parties with the same effect as if mentioned in each instance where a party is named or referred to, except that no violation of the provisions of Article 8 shall operate to vest any rights in any successor or assignee of Tenant and that the provisions of this Article shall not be construed as modifying the conditions of limitation contained in Article 24. However, the obligations of Landlord under this Lease shall not be binding upon Landlord herein named with respect to any period subsequent to the transfer of its interest in the Building as owner or lessee thereof and in event of such transfer said obligations shall thereafter be binding upon each transferee of the interest of Landlord herein named as such owner or lessee of the Building, but only with respect to the period ending with a subsequent transfer within the meaning of this Article.

36.02. If Landlord shall be an individual, joint venture, tenancy in common, partnership, unincorporated association, or other unincorporated aggregate of individuals and/or entities or a corporation, Tenant shall look only to such Landlord's estate and property in the Building (or the proceeds thereof) and, where expressly so provided in this Lease, to offset against the rents payable under this Lease for the collection of a judgment (or other judicial process) which requires the payment of money by Landlord in the event of any default by Landlord hereunder. No other property or assets of such Landlord shall be subject to levy, execution or other enforcement procedure for the satisfaction of Tenant's remedies under or with respect to this Lease, the relationship of Landlord and Tenant hereunder or Tenant's use or occupancy of the Demised Premises. Further, Tenant agrees that Landlord shall not be liable to Tenant for any special, indirect, or consequential damages arising out of Landlord's breach of this Lease.

ARTICLE 37

CONSENTS

37.01. Wherever it is specifically provided in this Lease that a party's consent is not to be unreasonably withheld, a response to a request for such consent shall also not be unreasonably delayed. If either Landlord or Tenant considers that the other had unreasonably withheld or delayed a consent, it shall so notify the other party within ten (10) days after receipt of notice of denial of the requested consent or, in case notice of denial is not received, within twenty (20) days after making its request for the consent.

37.02. Tenant hereby waives any claim against Landlord which it may have based upon any assertion that Landlord has unreasonably withheld or unreasonably delayed any such consent, and Tenant agrees that its sole remedy shall be an action or proceeding to enforce any such provision or for specific performance, injunction or declaratory judgment. In the event of such determination, the requested consent shall be deemed to have been granted, however, Landlord shall have no liability to Tenant for its refusal or failure to give such consent. The sole

remedy for Landlord's unreasonably withholding or delaying of consent shall be as provided in this Article.

ARTICLE 38

MORTGAGE FINANCING - TENANT COOPERATION

38.01. In the event that Landlord desires to seek mortgagee financing secured by the Demised Premises, Tenant agrees to cooperate with Landlord in the making of any application(s) by Landlord for such financing including the delivery to Landlord's mortgage broker or mortgagee, of such information as they shall require with respect to Tenant's occupancy of the Demised Premises, including, but not limited to the current financial statement of Tenant, but Tenant shall not be required to deliver such information directly to Landlord, all of the above to be at no cost and expense of Tenant. In the event that Landlord's mortgagee shall request changes to the within Lease in order to make same acceptable to Landlord's mortgagee, Tenant agrees to consent to such changes, provided such changes shall not affect the term of this Lease nor the financial obligations of Tenant hereunder.

ARTICLE 39

ENVIRONMENTAL COMPLIANCE

39.01. Tenant shall, at Tenant's sole cost and expense, comply with the New Jersey Industrial Site Recovery Act and the regulations promulgated hereunder (referred to as "ISRA") as same relate to Tenant's occupancy of the Demised Premises, as well as all other state, federal or local environmental law, ordinance, rule, or regulation either in existence as of the date hereof or enacted or promulgated after the date of this Lease, that concern the management, control, discharge, treatment and/or removal of hazardous discharges or otherwise affecting or affected by Tenant's use and occupancy of the Demised Premises. Tenant represents that Tenant's SIC number is 7398, and does not subject it to ISRA. Tenant shall, at Tenant's own expense, make all submissions to, provide all information to, and comply with all requirements of the Bureau of Industrial Site Evaluation (the "Bureau") of the New Jersey Department of Environmental Protection ("NJDEP"). Should the Bureau or any other division of NJDEP, pursuant to any other environmental law, rule, or regulation, determine that a cleanup plan be prepared and that a cleanup be undertaken because of any spills or discharge of hazardous substances or wastes at the Demised Premises which occur during the term of this Lease and were caused by Tenant or its agents or contractors, then Tenant shall, at Tenant's own expense prepare and submit the required plans and financial assurances, and carry out the approved plans. In the event that Landlord shall have to comply with ISRA by reason of Landlord's actions, Tenant shall promptly provide all information requested by Landlord for preparation of non-applicability affidavits or a Negative Declaration and shall promptly sign such affidavits when requested by Landlord. Tenant shall indemnify, defend, and save harmless Landlord from all fines, suits, procedures, claims, and actions of any kind arising out of or in any way connected with any spills or discharges of hazardous substances or wastes at the Demised Premises which occur during the term of this Lease and were caused by Tenant or its agents or contractors, and from all fines, suits, procedures, claims, and actions of any kind arising out of Tenant's failure to provide all

information, make all submission and take all actions required by the Bureau or any other division of NJDEP. Tenant's obligations and liabilities under this Paragraph shall continue so long as Landlord remains responsible for any spills or discharges of hazardous substances or wastes at the Demised Premises, which occur during the term of this Lease and were caused by Tenant or its agents or contractors. Tenant's failure to abide by the terms of this paragraph shall be restrainable by injunction. Tenant shall have no responsibility to obtain a "Negative Declaration" or "Letter of Non-Applicability" from the NJDEP if the sole reason for obtaining same is in connection with a sale or other disposition of the real estate by Landlord but Tenant agrees to cooperate with Landlord in Landlord's effort to obtain same and shall perform at Tenant's expense any clean up required by reason of Tenant's use and occupancy of the Demised Premises.

ARTICLE 40

HOLDING OVER

40.01. Tenant will have no right to remain in possession of all or part of the Demised Premises after the expiration of the term. If Tenant remains in possession of all or any part of the Demised Premises after the expiration of the Lease, without the express consent of Landlord: (a) such tenancy will be deemed to be a periodic tenancy from month-to-month only; (b) such tenancy will not constitute a renewal or extension of this Lease for any further term; and (c) such tenancy may be terminated by Landlord upon the earlier of (i) thirty (30) days prior written notice, or (ii) the earliest date permitted by law. In such event, monthly rent will be increased to an amount equal to two hundred percent (200%) of the monthly rent payable during the last month of the term, and any other sums due under this Lease will be payable in the amount and at the times specified in this Lease. Such month-to-month tenancy will be subject to every other term, condition, and covenant contained in this Lease. The provisions of this Section shall not be construed to relieve Tenant from liability to Landlord for damages resulting from any such holding over, or preclude Landlord from implementing summary dispossess proceedings. Tenant further acknowledges that its failure to perform any restoration required of it under this Lease shall be deemed the same as its remaining in possession of the Demised Premises after the expiration of the term, subjecting it to hold-over rent in accordance with this Article 40.

ARTICLE 41

CERTAIN DEFINITIONS AND CONSTRUCTIONS

41.01. For the purpose of this Lease and all agreements supplemental to this Lease, unless the context otherwise requires, the definitions set forth in Exhibit F annexed hereto shall be utilized.

41.02. The various terms which are italicized and defined in other Articles of this Lease or are defined in Exhibits annexed hereto, shall have the meanings specified in such other Articles and such Exhibits for all purposes of this Lease and all agreements supplemental thereto, unless the context shall otherwise require.

41.03. The submission of this Lease for examination does not constitute a reservation of, or option for, the Demised Premises, and this Lease becomes effective as a Lease only upon execution and delivery thereof by Landlord and Tenant.

41.04. The Article headings in this Lease and the Index prefixed to this Lease are inserted only as a matter of convenience in reference and are not to be given any effect whatsoever in construing this Lease.

ARTICLE 42

RELOCATION OF TENANT

42.01. Landlord at its sole expense, on at least sixty (60) days prior written notice, may require Tenant to move from the Demised Premises to another location of comparable size and decor in the Building or in the building(s) commonly known and designated as 399 Thornall Street, 499 Thornall Street, Edison, New Jersey or any future Landlord related, properties within the Metro Park Office Complex. By written notice to Landlord served within five (5) days of Tenant's receipt of the relocation notice, Tenant may elect not to move to the other space and in lieu thereof may terminate this Lease. In the event of any such relocation, Landlord shall be responsible for the expenses of preparing and decorating the relocated premises so that they will be substantially similar to the Demised Premises described in Exhibit C. Notwithstanding the foregoing, Landlord shall be entitled to rescind its notice of relocation within forty-five (45) days of its having forwarded to Tenant the notice of relocation or within forty-eight (48) hours of Tenant having properly elected to terminate this Lease. In the event Landlord rescinds the notice as aforesaid, this Lease shall continue in full force and effect.

IN WITNESS WHEREOF, Landlord and Tenant have duly executed this Lease as of the day and year first above written.

WITNESS:

LANDLORD:
METRO FOUR ASSOCIATES
LIMITED PARTNERSHIP
a New Jersey Limited Partnership

/s/ [ILLEGIBLE]

/s/ Dominick Alfieri

By: Dominick Alfieri
Title: General Partner

ATTEST:

TENANT:
PAMEX CAPITAL PARTNERS, L.L.C.
a New Jersey Limited Liability Company

/s/ [ILLEGIBLE]

/s/ James Leber

By: JAMES LEBER
Title: EXECUTIVE VICE PRESIDENT

EXHIBIT A

DESCRIPTION OF LAND
379 THORNALL STREET

ALL that certain tract, lot and parcel of land lying and being in the Township of Edison, County of Middlesex, and State of New Jersey being more particularly described as follows:

BEGINNING at a point in the new Southeasterly Right-of-Way line of Thornall Street, distant Southwestwardly 1,544.77 feet from the intersection formed by the Southeasterly Right-of-Way line of Thornall Street, with the Southwesterly Right-of-Way line of Wood Avenue South and from said beginning point running:

1. South 53 degrees 23 minutes 59 seconds East, along a new line in Lot 2-B-4 in Block 676, as shown on the current Township of Edison Tax Map, 264.80 feet to a point; running thence
2. South 36 degrees 36 minutes 01 second West, 76.19 feet to a point; running thence
3. South 53 degrees 23 minutes 59 seconds East, 612.14 feet to a point; running thence
4. South 31 degrees 14 minutes 31 seconds West, along the common line between Lots 2-B-4 and 5, in Block 676, as shown on the current Township of Edison Tax Map, 280.48 feet to a point, running thence
5. North 53 degrees 23 minutes 59 seconds West, along the common line between Lots 2-B-3 and 2-A, in Block 676, as shown on said Tax Map, 889.65 feet to a point in the new Southeasterly Right-of-Way line of Thornall Street; running thence
6. Northeastwardly, along the new Southeasterly Right-of-Way line of Thornall Street, along a curve to the left having a radius of 4,694.00 feet and an arc length of 355.79 feet to a point, said point being the point and place of BEGINNING.

Being also known as Lot 2-B-3 in Block 676, on the current Tax Map of the Township of Edison, Middlesex County, New Jersey.

Subject to easements, restrictions and covenants of record and such state of facts as an accurate survey may reveal.

EXHIBIT B
FLOOR PLAN
SEE ATTACHED
1B

[FLOOR MAP]

EXHIBIT 'B'

EXHIBIT C

HVAC SPECIFICATIONS

Perimeter baseboard electric heat, central high velocity fan system with Barber Coleman mixing boxes, featuring return heat of light recaptured. System utilizes a minimum of 10% to a maximum of 100% fresh air to maintain no less than 68 degrees interior at zero degrees exterior, with a 15-mile per hour wind. Air cooling shall maintain no more than 78 degrees F dry bulb with approximately 50% relative humidity when the outdoor conditions are 91 degrees F dry bulb. Dual system - building standard. The above standard is for normal office use only which shall be deemed to be one person for every 200 sq. ft. in any given or confined area which shall not include areas with special HVAC requirements such as computer rooms, conference rooms, cafeterias, high density or excessive heat producing equipment. Perimeter baseboard electric heat is used during the winter operations and an air cooling system is utilized during summer operations. One (1) diffuser per 250 sq. ft. of usable area. The foregoing in Landlord's Building Standard HVAC and shall not apply to any special HVAC requirements above Landlord's Building Standard such as computer rooms, conference rooms, cafeterias, high density or excessive heat used during winter operations and air cooling system. Any supplemental HVAC placed in the Demised Premises shall be repaired and maintained by Landlord or Landlord's contractor at Tenant's sole expense.

EXHIBIT D

CLEANING AND MAINTENANCE SPECIFICATIONS

Landlord will provide building standard cleaning services to the tenant area and the ground floor lobby area in accordance with the following specifications:

1. GENERAL CLEANING

NIGHTLY

- a. Empty all waste receptacles, removing waste to designated central location for disposal.
- b. Empty and wipe clean all ashtrays. Screen and clean all sand urns.
- c. Wash and disinfect all water coolers and drinking fountains.
- d. Wipe clean fingermarks, smudges, etc. from all doors and wall surfaces.
- e. Clean all tenant's interior stairways.
- f. Replace plastic liners in all waste-disposal cans.

WEEKLY

- a. Hand-dust all office equipment, furniture, fixtures, including panelling, shelving, window sills, telephones, door louvers, and all flat surfaces with a treated cloth or yard duster.

2. GROUP A - Ceramic tile, marble, terrazzo.

GROUP B - Linotile, asphalt, koroseal, plastic vinyl, rubber, wood, cork, or other types of floors and base.

NIGHTLY

- a. All floors in Group A to be swept and wet-mopped
- b. All floors in Group B to be dry mopped, using a "dustdown" preparation, and spots to be removed by wet process.

PERIODIC

- a. A wet mopping, waxing, buffing, stripping, or machine scrubbing of the floors in Group B will be accomplished whenever required to maintain a hard lustrous finish and will be governed by the amount of wear due to weather and other conditions.

3. VACUUMING

NIGHTLY

- a. Vacuum once per week. Carpet-sweep four times per week all rugs and carpeted areas, moving light furniture and office equipment other than desks and file cabinets. Spot clean to remove soluble spots, which safely respond to standard spotting procedures without risk of injury to color or fabric.

4. HIGH DUSTING

PERIODIC

- a. Dust all closet shelving and wash all closet floors when accessible, monthly.
- b. Damp dust all pictures, charts, graphs, etc., not reached in nightly cleaning, quarterly.
- c. Dust clean all vertical surfaces such as walls, partitions, doors, door bucks, and other surfaces not reached in nightly cleaning, quarterly.
- d. Damp dust ceiling air conditioning diffusers, wall grills, door louvers, registers, and venetian blinds, quarterly.
- e. Dust exterior of light fixtures, annually.

5. WASHROOMS AND TOILETS

NIGHTLY

- a. Sweep, mop, rinse, and dry floors. Polish mirrors and bright-work. Clean enameled surfaces.
- b. Wash and disinfect basins, urinals, and bowls using scouring powder to remove stains, making certain to clean undersides of rims of urinals and bowls.
- c. Wash and disinfect both sides of all toilet seats.

- d. Supply and service all toilet tissue, soap, towels, and sanitary napkins. Sanitary Napkins will be supplied in coin operated dispensers.
- e. All wastepaper cans and all receptacles are to be emptied and new plastic liners installed.
- f. Hand dust and wash clean all partitions, tile walls, dispensers, and receptacles in lavatories and vanity area.
- g. Empty and clean sanitary disposal receptacles.

WEEKLY

- a. Wash down walls in washrooms and stalls, from trim to floor.

6 . ELEVATORS

NIGHTLY

- a. Clean the floor in accordance with specifications outlined above based upon the type of flooring installed. The doors, surfaces, and fixtures shall be dusted daily and damp wiped weekly.

7. GLASS

PERIODIC

- a. Clean both sides of all lobby glass including the building entrance doors, nightly
- b. Clean all perimeter windows quarterly.
- c. Clean glass partitions, doors, and furniture once every six months (limited to reasonable quantities).

8. MISCELLANEOUS

- a. Check all stairwells and landings nightly throughout entire demised area, and keep in clean condition. All stairways and landings will be dry mopped nightly. Railings, ledges, and equipment will be dusted nightly. These areas will be wet mopped weekly, scrubbed when necessary, and shall be waxed and buffed weekly where required.
- b. Wipe down mail chute and mail depository nightly.

- c. On completion of work, all slop sinks are to be thoroughly cleaned, and cleaning equipment to be stored neatly in designated locations.
- d. All cleaning services except those performed by day porters, window cleaners, and matrons are to be performed nightly, five nights per week. No Saturday, Sunday or bank holiday service to be provided. In no event shall performance of any cleaning service interfere with Tenant's normal business operation.
- e. The Contractor or Landlord is to furnish all necessary approved cleaning materials, implements, and machinery for the satisfactory completion of the work. This includes scaffolding, vacuum machines, scrubbing machines, etc.
- f. Contractor shall furnish proof of liability and property damage insurance suitable to the bank, and Workman's Compensation Insurance in amounts required under the laws of New Jersey.
- g. Tenant will be charged for cleaning services in excess of the specifications outlined above.
- h. Tenant will be charged for the incremental cost to clean any areas of the Demised Premises used for special purposes requiring more difficult cleaning work than office areas including, but not limited to, private toilets and showers, dining areas, cafeteria, kitchen, etc.

EXHIBIT E

RULES AND REGULATIONS

1. The rights of tenants in the entrances, corridors, elevators, and escalators of the Building are limited to ingress to and egress from the tenants' demised premises for the tenants and their employees, licensees, and invitees, and no tenant shall use or permit the use of the entrances, corridors, escalators, or elevators for any other purpose. No tenant shall invite to the tenant's demised premises, or permit the visit of, persons in such numbers or under such conditions as to interfere with the use and enjoyment of any of the plazas, entrances, corridors, escalators, elevators, and other facilities of the Building by other tenants. Fire exits and stairways are for emergency use only, and they shall not be used for any other purpose by the tenants, their employees, licensees, or invitees. No tenant shall encumber or obstruct, or permit the encumbrance or obstruction of any of the sidewalks, plazas, entrances, corridors, escalators, elevators, fire exits, or stairways of the Building. The Landlord reserves the right to control and operate the public portions of the Building and the public facilities, as well as facilities furnished for the common use of the tenants, in such manner as it deems best for the benefit of the tenants generally.

2. The Landlord may refuse admission to the Building outside of ordinary business hours to any person not having a pass issued by the Landlord or the tenant whose demised premises are to be entered or not otherwise properly identified, and may require all persons admitted to or leaving the Building outside of ordinary business hours to register. Any person whose presence in the Building at any time shall, in the judgment of the Landlord, be prejudicial to the safety, character, reputation, and interests of the Building or of its tenants may be denied access to the Building or may be ejected therefrom. In case of invasion, riot, public excitement, or other commotion, the Landlord may prevent all access to the Building during the continuance of the same, by closing the doors or otherwise, for the safety of the tenants and protection of property of the Building. The Landlord may require any person leaving the Building with any package or other object to exhibit a pass from the tenant from whose premises the packaging or object is being removed, but the establishment and enforcement of such requirement shall not impose any responsibilities on the Landlord for the protection of any tenant against the removal of property from the premises of the tenant. The Landlord shall in no way be liable to any tenant for damages or loss arising from the admission, exclusion, or ejection of any person to or from the tenant's premises or the Building under the provisions of this rule. Canvassing, soliciting, or peddling in the Building is prohibited, and every tenant shall cooperate to prevent the same.

3. No tenant shall obtain or accept for use in its demised premises ice, food for on premises preparation other than warming, beverage towel, barbering, boot blackening, floor polishing, lighting maintenance, cleaning, or other similar services from any persons not authorized by the Landlord in writing to furnish such services, provided that the charges for such services by persons authorized by the Landlord are not excessive and where appropriate and consonant with the security and proper operation of the Building sufficient persons are so

authorized for the same service to provide tenants with a reasonably competitive selection. Such services shall be furnished only at such hours, in such places within the Tenants' Demised Premises and under such reasonable regulations as may be fixed by the Landlord. Tenant may have a coffee service, subject to Landlord's approval, and a kitchen for the use of its employees commensurate with normal office use.

4. The cost of repairing any damage to the public portions of the Building or the public facilities or to any facilities used in common with other tenants, caused by a tenant or the employees, licensees, or invitees of the tenant shall be paid by such tenant.

5. No lettering, sign, advertisement, notice or object shall be displayed in or on the windows or doors, or on the outside of any tenant's demised premises, or at any point inside any tenant's premises where the same might be visible outside of such demised premises, except that the name of the tenant may be displayed on the entrance door of the tenant's demised premises, and in the elevator lobbies of the floors which are occupied entirely by any tenant, subject to the approval of the Landlord as to the size, color, and style of such display. The inscription of the name of the tenant on the door of the tenant's demised premises shall be done by the Landlord at the expense of the tenant.

6. No awnings or other projections over or around the windows shall be installed by any tenant, and only such window blinds as are supplied or permitted by the Landlord shall be used in a tenant's demised premises. Linoleum, tile, or other floor covering shall be laid in a tenant's demised premises only in a manner approved by the Landlord.

7. The Landlord shall have the right to prescribe the weight and position of safes and other objects of excessive weight, and no safe or other object whose weight exceeds the lawful load for the area upon which it would stand shall be brought into or kept upon a tenant's demised premises. If, in the judgment of the Landlord, it is necessary to distribute the concentrated weight of any heavy object, the work involved in such distribution shall be done at the expense of the tenant and in such manner as the Landlord shall determine. The moving of safes and other heavy objects shall take place only outside of ordinary business hours upon the same upon previous notice to the Landlord, and the persons employed to move the same in and out of the Building shall be reasonably acceptable to the Landlord and if so required by law, shall hold a Master Rigger's license. Freight, furniture, business equipment, merchandise, and bulky matter of any description shall be delivered to and removed from the demised premises only in the freight elevators and through the service entrances and corridors, and only during hours and in a manner approved by the Landlord. Arrangements will be made by the Landlord with any tenant for moving large quantities of furniture and equipment into or out of the Building.

8. No machines or mechanical equipment of any kind other than typewriters and other ordinary portable business machines, may be installed or operated in any tenant's demised premises without Landlord's prior written consent, and in no case (even where the same are of a type so accepted or as so consented to by Landlord) shall any machines or mechanical equipment be so placed or operated as to disturb other tenants; but machines and mechanical equipment which may be permitted to be installed and used in a tenant's demised premises shall be

so equipped, installed and maintained by such tenant as to prevent any disturbing noise, vibration, or electrical or other interference from being transmitted from such premises to any other area of the Building.

9. No noise, including the playing of any musical instruments, radio or television, which, in the judgment of the Landlord might disturb other tenants in the building, shall be made or permitted by any tenant, and no cooking shall be done in the tenant's demised premises, except as expressly approved by the Landlord. Nothing shall be done or permitted in any tenants' demised premises, and nothing shall be brought into or kept in any tenants' demised premises, which would impair or interfere with any of the Building services or the proper and economic heating, cleaning, or other servicing of the Building or the demised premises, or the use of enjoyment by any other tenant of any other demised premises, nor shall there be installed by any tenant any ventilating, air conditioning, electrical or other equipment of any kind which, in the judgment of the Landlord, might cause any such impairment or interference. No dangerous, inflammable, combustible, or explosive object or material shall be brought into the building by any tenant or with the permission of any tenant. Any cuspidors or similar containers or receptacles used in any tenants' demised premises shall be cared for and cleaned by and at the expense of the tenant.

10. No acids, vapors, or other materials shall be discharged or permitted to be discharged into the waste lines, vents or flues of the Building which may damage them. The water and wash closets and other plumbing fixtures in or serving any tenant's premises shall not be used for any purpose other than the purposes for which they were designed or constructed, and no sweepings, rubbish, rags, acids or other foreign substances shall be deposited therein.

11. No additional locks or bolts of any kind shall be placed upon any of the doors or windows in any tenants' demised premises and no lock on any door therein shall be changed or altered in any respect. Additional keys for a tenant's demised premises and toilet rooms shall be procured only from the Landlord, which may make a reasonable charge therefor. Upon the termination of a tenant's lease, all keys of the tenant's demised premises and toilet rooms shall be delivered to the Landlord.

12. All entrance doors in each tenants' demised premises shall be left locked, and all windows shall be left closed by the tenant when the tenant's demised premises are not in use. Entrance doors shall not be left open at any time.

13. Hand trucks not equipped with rubber tires and side guards shall not be used within the Building.

14. All windows in each tenant's demised premises shall be kept closed and all blinds therein above the ground floor shall be lowered when and as reasonably required because of the position of the sun, during the operation of the Building air conditioning system to cool or ventilate the tenant's demised premises.

15. The Landlord reserves the right to rescind, alter, or waive any rule or regulation at any time prescribed for the Building when, in its judgment, it deems it necessary, desirable, or proper for its best interest and for the best interests of the tenants, and no alteration or waiver of any rule or regulation in favor of one tenant shall operate as an alteration or waiver in favor of any other tenant. The Landlord shall not be responsible to any tenant for the nonobservance or violation by any other tenant of any of the rules and regulations at any time prescribed by the Building.

EXHIBIT F

DEFINITIONS

(a) The term "mortgage" shall mean an indenture of mortgage and deed of trust to a trustee to secure an issue of bonds, and the term "mortgagee" shall mean such a trustee.

(b) The terms "include," "including," and "such as" shall each be construed as if followed by the phrase "without being limited to."

(c) References to Landlord as having no liability to Tenant or being without liability to Tenant, shall mean the Tenant is not entitled to terminate this Lease, or to claim actual or constructive eviction, partial or total, or to receive any abatement or diminution of rent, or to be relieved in any manner of any of its other obligations hereunder, or to be compensated

(d) The term laws and/or requirements of public authorities and words of like import shall mean laws and ordinances of any or all of the Federal, state, city, county, and borough governments and rules, regulations, orders and/or directives of any or all departments, subdivisions, bureaus, agencies, or office thereof, or of any other governmental, public, or quasipublic authorities, having jurisdiction in the premises, and/or the direction of any public officer pursuant to law.

(e) The term requirements of insurance bodies and words of like import shall mean rules, regulations, orders, and other requirements of the New Jersey Board of Fire Underwriters and/or similar body performing the same or similar functions and having jurisdiction or cognizance of the Building and/or the Demised Premises.

(f) The term repair shall be deemed to include restoration and replacement as may be necessary to achieve and/or maintain good working order and condition.

(g) Reference to termination of this Lease includes expiration or earlier termination of the term of this Lease or cancellation of this Lease pursuant to any of the provisions of this Lease or to law. Upon a termination of this Lease, the term and estate granted by this Lease shall end at noon of the date of termination as if such date were the date of expiration of the term of this Lease and neither party shall have any further obligation or liability to the other after such termination (i) except as shall be expressly provided for in this Lease, or (ii) except for such obligation as by its nature or under the circumstances can only be, or by the provisions of this Lease, may be performed after such termination and, in any event, unless expressly otherwise provided in this Lease, any liability for a payment which shall have accrued to or with respect to any period ending at the time of termination shall survive the termination of this Lease.

[FLOOR MAP]

EXHIBIT G

[FLOOR MAP]

SCHEDULE 2

AMENDMENT NUMBER FIVE
to the
Amended and Restated Master Loan and Security Agreement
dated as of March 27, 2000
Among
HANOVER CAPITAL MORTGAGE HOLDINGS, INC.,
HANOVER CAPITAL PARTNERS, LTD.
and
GREENWICH CAPITAL FINANCIAL PRODUCTS, INC.

This AMENDMENT NUMBER FIVE (this "Amendment") is made this 28th day of March, 2002, among HANOVER CAPITAL MORTGAGE HOLDINGS, INC., HANOVER CAPITAL PARTNERS, LTD. (each, a "Borrower" and collectively, the "Borrowers") and GREENWICH CAPITAL FINANCIAL PRODUCTS, INC. (the "Lender") to the MASTER LOAN AND SECURITY AGREEMENT, dated as of March 27, 2000, between the Lender and the Borrowers, as amended (the "Loan Agreement").

RECITALS

WHEREAS, the Borrowers have requested that the Lender agree to amend the Loan Agreement to extend the Termination Date thereunder and the Borrowers and the Lender have agreed to make such additional modifications to the Loan Agreement as more expressly set forth below.

WHEREAS, as of the date of this Amendment, the Borrowers represent to the Lender that they are in compliance with all of the representations and warranties and all of the affirmative and negative covenants set forth in the Loan Agreement and are not in default under the Loan Agreement.

WHEREAS, in order to induce the Lender to enter into this Amendment Number Five the Borrowers have agreed to pay the Lender a facility fee in an amount equal to \$150,000.

NOW THEREFORE, for good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, and of the mutual covenants herein contained, the parties hereto hereby agree as follows:

SECTION 1. Effective as of March 28, 2002, the definition of "Business Day" in Section 1 of the Loan Agreement is hereby amended to read in its entirety as follows:

"Business Day" shall mean any day other than (i) a Saturday or Sunday, (ii) a day on which the New York Stock Exchange, the Federal Reserve Bank of New York, the Custodian or banking and savings and loan institutions in the State of New York or Connecticut or the City of New York or the city or state in which the Custodian's offices are located are closed, or (iii) a day on which trading in securities on the New York Stock

Exchange or any other major securities exchange in the United States is not conducted.

SECTION 2. Effective as of March 28, 2002, the definition of "Termination Date" in Section 1 of the Loan Agreement is hereby amended to read in its entirety as follows:

"Termination Date" shall mean March 27, 2003 or such earlier date on which this Loan Agreement shall terminate in accordance with the provisions hereof or by operation of law.

SECTION 3. Effective as of March 28, 2002, Section 2 of the Loan Agreement is hereby amended by deleting Section 2.10 in its entirety and inserting in its place "2.10 [Intentionally Omitted]."

SECTION 4. Effective as of March 28, 2002, Section 3.05 of the Loan Agreement is hereby amended to read in its entirety as follows:

3.05 Non-usage Fee. The Borrowers agree to pay to the Lender, on June 30, 2002, September 30, 2002, December 30, 2002 and March 27, 2003, in addition to any other fees then payable, a non-usage fee equal to (a) 12.5 basis points (0.125%) multiplied by (b)(i) the number of days from and including March 28, 2002 or the previous payment date of such Non-usage Fee up to but not including the related payment date of such Non-usage Fee or the Termination Date, as applicable, during which the unused portion of the Maximum Committed Amount exceeded \$5,000,000, divided by (ii) 360, multiplied by (c) the average daily amount of the entire unused portion of the Maximum Committed Amount for the applicable days on which the unused portion of the Maximum Committed Amount exceeded \$5,000,000, such payment to be made in Dollars, in immediately available funds, without deduction, set-off, or counterclaim. The Lender may, in its sole discretion, net such Non-usage Fee from the proceeds of any Advance made to a Borrower hereunder.

SECTION 5. Effective as of March 28, 2002, Section 3.06 of the Loan Agreement is hereby amended to read in its entirety as follows:

3.06 Facility Fee. On March 28, 2002, the Borrowers shall pay to the Lender a facility fee in connection with the extension of the Termination Date hereunder, equal to \$150,000. Such facility fee shall not be subject to offset or credit against any underwriting fees earned by the Lender at any time. The extension of the Termination Date to March 27, 2003 shall become effective upon receipt by the Lender of such facility fee.

SECTION 6. Effective as of March 28, 2002, Section 5.02(j) of the Loan Agreement is hereby amended to read in its entirety as follows:

- (j) No Material Adverse Effect or Other Event. There shall not have occurred:
- (i) one or more events that, in the reasonable judgment of the Lender, constitutes or should reasonably be expected to constitute a Material Adverse Effect; or
 - (ii) an event or events resulting in the inability of the Lender to finance any Advances with traditional counterparties at rates which would have been reasonable prior to the occurrence of such event or events or a material adverse change in the financial condition of the Lender which affects (or can reasonably be expected to affect) materially and adversely the ability of the Lender to fund its obligations under or otherwise comply with the terms of this Loan Agreement; or
 - (iii) any other event beyond the control of the Lender which the Lender reasonably determines may result in the Lender's inability to perform its obligations under this Loan Agreement including, without limitation, acts of God, strikes, lockouts, riots, acts of war or terrorism, epidemics, nationalization, expropriation, currency restrictions, fire, communication line failures, computer viruses, power failures, earthquakes, or other disasters of a similar nature to the foregoing.

SECTION 7. Effective as of March 28, 2002, Section 7 of the Loan Agreement is hereby amended by adding the following new Section 7.27 to read in its entirety as follows:

7.27 Certificate of a Responsible Officer of the Borrowers. Not later than the last Business Day of each month, each Borrower shall forward to the Lender (to the attention of the Credit Department) a certificate of a Responsible Officer of such Borrower which demonstrates that such Borrower is in compliance with the covenants set forth in Section 7.09 of this Loan Agreement.

SECTION 8. Effective as of March 28, 2002, Section 11.17 of the Loan Agreement is hereby amended to read in its entirety as follows:

"11.17 Set-Off. In addition to any rights and remedies of the Lender provided by this Loan Agreement and by law, the Lender shall have the

right, without prior notice to the Borrowers, any such notice being expressly waived by the Borrowers to the extent permitted by applicable law, upon any amount becoming due and payable by the Borrowers hereunder (whether at the stated maturity, by acceleration or otherwise) to set-off and appropriate and apply against such amount any and all property and deposits (general or special, time or demand, provisional or final), in any currency, and any other credits, indebtedness or claims, in any currency, in each case whether direct or indirect, absolute or contingent, matured or unmatured, at any time held or owing by the Lender or any Affiliate thereof to or for the credit or the account of either Borrower. The Lender may set-off cash, the proceeds of the liquidation of any Collateral and all other sums or obligations owed by the Lender or its Affiliates to either Borrower against all of either Borrowers' obligations to the Lender or its Affiliates, whether under this Loan Agreement or under any other agreement between the parties or between either Borrower and any Affiliate of the Lender, or otherwise, whether or not such obligations are then due, without prejudice to the Lender's or its Affiliate's right to recover any deficiency. The Lender agrees promptly to notify the related Borrower after any such set-off and application made by the Lender; provided that the failure to give such notice shall not affect the validity of such set-off and application."

SECTION 9. Fees and Expenses. The Borrower agrees to pay to the Lender all fees and out of pocket expenses incurred by the Lender in connection with this Amendment (including all reasonable fees and out of pocket costs and expenses of the Lender's legal counsel incurred in connection with this Amendment Number Five), in accordance with Section 11.03 of the Loan Agreement

SECTION 10. Facility Fee. In order to induce the Lender to enter into this Amendment Number Five, the Borrowers hereby agree to pay to the Lender, in addition to any other amounts required pursuant to the Agreement, a facility fee equal to \$150,000 to be paid to the Lender upon execution of this Amendment Number Five. Such facility fee shall be paid in dollars, in immediately available funds, in accordance with the Lender's instructions. This Amendment Number Five shall be effective upon the Lender's receipt of such facility fee.

SECTION 11. Defined Terms. Any terms capitalized but not otherwise defined herein shall have the respective meanings set forth in the Loan Agreement.

SECTION 12. Representations. In order to induce the Lender to execute and deliver this Amendment Number Five, the Borrowers hereby represent to the Lender that as of the date hereof, after giving effect to this Amendment Number Five, the Borrowers are in full compliance with all of the terms and conditions of the Loan Agreement and no Default or Event of Default has occurred under the Loan Agreement.

SECTION 13. Limited Effect. Except as expressly amended and modified by this Amendment Number Five, the Loan Agreement shall continue in full force and effect in accordance with its terms. Reference to this Amendment Number Five need not be made in the Loan Agreement or any other instrument or document executed in connection therewith, or in any certificate, letter or communication issued or made pursuant to, or with respect to, the Loan Agreement, any reference in any of such items to the Loan Agreement being sufficient to refer to the Loan Agreement as amended hereby.

SECTION 14. GOVERNING LAW. THIS AMENDMENT NUMBER FIVE SHALL BE CONSTRUED IN ACCORDANCE WITH THE LAWS OF THE STATE OF NEW YORK AND THE OBLIGATIONS, RIGHTS, AND REMEDIES OF THE PARTIES HEREUNDER SHALL BE DETERMINED IN ACCORDANCE WITH SUCH LAWS WITHOUT REGARD TO CONFLICT OF LAWS DOCTRINE APPLIED IN SUCH STATE (OTHER THAN SECTION 5-1401 OF THE NEW YORK GENERAL OBLIGATIONS LAW).

SECTION 15. Counterparts. This Amendment Number Five may be executed by each of the parties hereto on any number of separate counterparts, each of which shall be an original and all of which taken together shall constitute one and the same instrument.

[SIGNATURE PAGE FOLLOWS]

IN WITNESS WHEREOF, the Borrowers and the Lender have caused this Amendment Number Five to be executed and delivered by their duly authorized officers as of the day and year first above written.

HANOVER CAPITAL MORTGAGE
HOLDINGS, INC.
BORROWER

By: _____
Name: _____
Title: _____

HANOVER CAPITAL PARTNERS, LTD.
BORROWER

By: _____
Name: _____
Title: _____

GREENWICH CAPITAL FINANCIAL
PRODUCTS, INC.,
LENDER

By: _____
Name: _____
Title: _____

AMENDMENT NUMBER SIX
to the
Amended and Restated Master Loan and Security Agreement
Dated as of March 27, 2000
among
HANOVER CAPITAL MORTGAGE HOLDINGS, INC.
HANOVER CAPITAL PARTNERS LTD
and
GREENWICH CAPITAL FINANCIAL PRODUCTS, INC.

This AMENDMENT NUMBER SIX is made this 27th day of March, 2003, among HANOVER CAPITAL MORTGAGE HOLDINGS, INC. and HANOVER CAPITAL PARTNERS LTD, each having an address at 379 Thornall Street, Edison, New Jersey, 08837 (each, a "Borrower" and collectively, "the Borrowers") and GREENWICH CAPITAL FINANCIAL PRODUCTS, INC., and having an address at 600 Steamboat Road, Greenwich, Connecticut 06830 (the "Lender"), to the Amended and Restated Master Loan and Security Agreement, dated as of March 27, 2000, by and between the Borrowers and the Lender, as amended (the "Agreement"). Capitalized terms used but not otherwise defined herein shall have the meanings assigned to such terms in the Agreement.

RECITALS

WHEREAS, the Borrowers have requested that the Lender agree to amend the Agreement, subject to the terms hereof, to extend the term thereof to April 27, 2003 and the Lender has agreed to such request.

WHEREAS, as of the date of this Amendment, the Borrowers represent to the Lender that they are in compliance with all of the representations and warranties and all of the affirmative and negative covenants set forth in the Agreement.

NOW THEREFORE, for good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, and of the mutual covenants herein contained, the parties hereto hereby agree as follows:

SECTION 1. Effective as of March 27, 2003, the definition of "Termination Date" in Section 1 of the Agreement is hereby amended to read in its entirety as follows:

"Termination Date" shall mean April 27, 2003 or such earlier date on which this Loan Agreement shall terminate in accordance with the provisions hereof or by operation of law.

SECTION 2. Defined Terms. Any terms capitalized but not otherwise defined herein should have the respective meanings set forth in the Agreement.

SECTION 3. Limited Effect. Except as amended hereby, the Agreement shall continue in full force and effect in accordance with its terms. Reference to this Amendment need not be made in the Agreement or any other instrument or document

executed in connection therewith, or in any certificate, letter or communication issued or made pursuant to, or with respect to, the Agreement, any reference in any of such items to the Agreement being sufficient to refer to the Agreement as amended hereby.

SECTION 4. Representations. The Borrowers hereby represent to the Lender that as of the date hereof, the Borrowers are in full compliance with all of the terms and conditions of the Agreement and no Default or Event of Default has occurred and is continuing under the Agreement.

SECTION 5. Governing Law. This Amendment Number Six shall be construed in accordance with the laws of the State of New York and the obligations, rights, and remedies of the parties hereunder shall be determined in accordance with such laws without regard to conflict of laws doctrine applied in such state (other than Section 5-1401 of the New York General Obligations Law).

SECTION 6. Counterparts. This Amendment Number Six may be executed by each of the parties hereto on any number of separate counterparts, each of which shall be an original and all of which taken together shall constitute one and the same instrument.

[REMAINDER OF THIS PAGE LEFT INTENTIONALLY BLANK]

IN WITNESS WHEREOF, the Borrowers and the Lender have caused this Amendment Number Six to be executed and delivered by their duly authorized officers as of the day and year first above written.

HANOVER CAPITAL MORTGAGE
HOLDINGS, INC.
(Borrower)

By:

Name: John A. Burchett
Title: Chief Executive Officer & President

HANOVER CAPITAL PARTNERS LTD
(Borrower)

By:

Name: John A. Burchett
Title: Chief Executive Officer

GREENWICH CAPITAL FINANCIAL PRODUCTS. INC.
(Lender)

By:

Name:
Title:

AMENDED AND RESTATED
LIMITED LIABILITY COMPANY
AGREEMENT
OF
HDMF-I LLC
Dated as of November 21, 2002

This AMENDED AND RESTATED LIMITED LIABILITY COMPANY AGREEMENT (this "Agreement") is made as of this 21st day of November, 2002 by and among LTD 2001 HDMF-1 Corp. ("LTD"), Hanover Capital Mortgage Holdings, Inc. ("HCMH") and Provident Financial Group, Inc. ("Provident"). LTD, HCMH and Provident are each individually referred to as a "Member" of HDMF-I LLC (the "Company"), and may collectively be described as the "Members."

RECITALS

A. This Agreement amends and restates the Limited Liability Company Agreement dated August 1, 2001 by and among the Members (the "Original Agreement").

B. Pursuant to the Original Agreement and the Certificate of Formation dated March 29, 2001 filed with the Delaware Secretary of State on March 29, 2001 (the "Certificate of Formation"), the Members formed the Company for the purpose of acquiring in one or more transactions certain pools (the "Pools") of primarily sub-performing and non-performing one-to-four family residential mortgage loans.

C. Pursuant to the Original Agreement, the Members agreed that Hanover Capital Mortgage Holdings, Inc. (the "Manager") would manage the business and affairs of the Company.

D. Pursuant to the Original Agreement, the Company entered into an asset management agreement dated August 1, 2001 (the "Asset Management Agreement") with Hanover Capital Partners Ltd. as asset manager (the "Asset Manager ") pursuant to which the Asset Manager, on behalf of the Company, shall exercise substantial authority and responsibility to oversee the management of, and assist in the sale of, the Assets. A copy of the Asset Management Agreement, as amended, is attached hereto as Exhibit B.

E. The Company has and intends from time to time to enter into a non-exclusive special servicing agreement (the "Servicing Agreement" and, together with each other agreement entered into by the Company from time to time relating to the servicing of one or more Pools, the "Servicing Agreements") with The Provident Bank and other Servicers. Pursuant to the Servicing Agreements, the Company has authorized The Provident Bank or will authorize other Servicers to exercise substantial authority and responsibility to service the Assets of one or more Pools. Each of the Members desires to confirm, as among themselves, the power of the Manager (acting at the direction of the Required Members) to select and replace the Servicers under the Servicing Agreements.

F. The Members desire to amend and restate the Original Agreement to, among other things, (i) expand the definition of "Assets" (as defined in the Original Agreement) to include sub-performing and non-performing (a) five-to-eight family residential and mixed use property mortgage loans and (b) cooperative loans, and thereby expand the purpose of the Company, and (ii) extend the "Investment Period" (as defined in the Original Agreement) to one (1) year after the date of this Agreement.

G. Certain capitalized terms used herein shall have the meanings ascribed to such terms in Schedule I hereto.

AGREEMENT

Each of the Members agrees as follows:

ARTICLE I

GENERAL

1.1 Formation of Limited Liability Company. The Members have formed the Company under and pursuant to the Delaware Limited Liability Company Act, 6 Del. C. Sections 18-101, et seq. (as such may be amended from time to time, and any successor to that act, the "Delaware Act"). Upon their execution of the Original Agreement, each of the Members was admitted to the Company as a member of the Company.

1.2 Name. The name of the Company is HDMF-I LLC.

1.3 Purpose. (a) Subject to Section 1.3(d) below, the Company is organized for the principal objects and purposes of (i) purchasing, holding, owning, financing, servicing and disposing of the Assets and the related collateral for the Assets, (ii) selecting and monitoring the performance of the Asset Manager under the Asset Management Agreement, (iii) selecting and monitoring the performance of the Servicers under the Servicing Agreements and (iv) engaging in any activities necessary, convenient or incidental to the foregoing.

(b) Subject to Section 1.3(d) below, the Company may, and the foregoing shall not limit the Company's authority and power to:

(i) organize one or more corporations, limited partnerships, memberships, limited liability companies, business trusts or other entities or arrangements for the purpose of purchasing, owning, financing, managing, operating, disposing of or otherwise dealing with any of the assets, liabilities, business and affairs of the Company, or any subsidiary thereof;

(ii) borrow money for Company purposes, with or without recourse to the Company (which borrowings may be made from one or more Members, their respective Affiliates or from institutional or other third-party lenders), but in no event with recourse to any Member, and pledge, mortgage or encumber the interest of the Company in any or all of the Assets and the other assets of the Company to one or more lenders as security for such borrowings; and

(iii) enter into, execute, deliver and perform all obligations, agreements and other instruments and do all other acts and things necessary or incidental to or desirable for the accomplishment of the foregoing or otherwise contemplated in this Agreement.

(c) Notwithstanding anything in this Agreement to the contrary, but subject to Section 1.3(d) and Article II below, the execution and delivery by the Company of, and the exercise by the Company of its rights and powers and the performance by the Company of its obligations under the following agreements, documents and instruments, and any assumptions, amendments or amendment and restatements thereof, are hereby expressly authorized, approved, ratified and confirmed in all respects and do not and will be deemed not to conflict with, contravene, violate or constitute a breach of or a default under any provision of or any duty under this Agreement:

(i) the Asset Management Agreement;

(ii) the Servicing Agreements;

(iii) all such agreements, documents and instruments as may be required in connection with the acquisition, holding, owning, financing, servicing and disposition of the Assets;

(iv) all such agreements, documents and instruments as may be executed in accordance with the terms of this Agreement and required in connection with the secured or unsecured financing and refinancing of the Company's acquisition, holding, owning, servicing and disposition of the Assets (collectively, the "Loan Pool Documentation"); and

(v) such other agreements, documents and instruments relating thereto or contemplated thereby that, in accordance with the terms of this Agreement, the Company may execute, enter into or agree to be bound by, or by which it may cause any of its assets or property to be bound.

(d) Notwithstanding anything to the contrary contained in this Agreement, including, without limitation, Sections 1.3(a)-(c) and Section 2.1 hereof, or the Asset Management Agreement, the Company, and the Manager, the Members, and any employee or agent of the Company or of the Manager or any Member, shall not engage in any activity (i) that would result in a violation of federal or state banking law, including, without limitation, laws applicable to FDIC insured depository institutions and the rules, regulations and interpretations of the FDIC, with respect to any Member, or (ii) without obtaining any Governmental Authorization of or from any applicable Governmental Body that is required pursuant to any Legal Requirement for the conduct of such activity.

1.4 Term. The term of the Company commenced on the date that the Certificate of Formation of the Company was filed with the Secretary of State of the State of Delaware and shall continue until dissolved as provided in Article VIII.

1.5 Place of Business. The principal place of business of the Company is 90 West Street, Suite 2210, New York, New York 10006, or such other place or places as may be determined from time to time by the Manager upon notice to the Members. The Company may

also maintain additional offices in such other places as may be determined from time to time by the Manager.

1.6 Registered Office and Registered Agent. The registered office of the Company in the State of Delaware is c/o The Corporation Trust Company, Corporation Trust Center, 1209 Orange Street, Wilmington, New Castle County, Delaware 19801. The registered agent for service of process on the Company in the State of Delaware at that address is The Corporation Trust Company.

1.7 Qualification. The Manager shall cause the Company to continue to be qualified and existing as a limited liability company under the Delaware Act and shall cause it to be qualified and registered as such in other jurisdictions if the Manager shall determine that it is appropriate for the Company to be so qualified or to be so registered.

ARTICLE II

DUTIES, POWERS AND LIABILITY OF MANAGER AND MEMBERS; CONFLICTS OF INTEREST; INDEMNIFICATION

2.1 Powers of Manager. (a) Except as otherwise specifically set forth in this Agreement, including, without limitation, Section 1.3(d) and Section 2.8 hereof, the Manager shall have full and complete charge of all affairs of the Company, and management and control of the operations of the Company shall be vested exclusively in the Manager, which shall have the power, on behalf of and in the name of the Company, to carry out any and all of the purposes of the Company and to perform all acts and enter into and perform all contracts and other undertakings which the Manager may deem necessary or advisable in furtherance thereof or incidental thereto. Without limiting the foregoing, the Company is empowered, and the Manager is hereby authorized and empowered on behalf of the Company, without obtaining the prior consent of any Member except as specifically required under any other provision of this Agreement (including, without limitation, Section 2.8 hereof), to:

(i) execute and deliver on behalf of the Company such proposals, bids, agreements in principle, definitive agreements and other documents of any character, and amendments to any of the foregoing, and to take such other actions in each case as it deems appropriate with respect to the purchase of Pools of Assets, including the making of any bid to purchase or otherwise acquire any Pool or other Asset, in accordance with Sections 2.8 and 4.2(b) hereof;

(ii) execute and deliver on behalf of the Company such agreements, instruments, and other documents of any character, and to take such other actions, in each case as it deems appropriate with respect to the sale or other disposition of the assets of the Company, including, but not limited to, the assignment, transfer or other disposition of any Pool of Assets;

(iii) execute and deliver on behalf of the Company obligations, agreements, instruments and other documents of any character relating to the business and affairs of the Company, including, without limitation, certificates and other documents in connection with the registration and qualification of the Company in any jurisdiction; certificates and other documents in connection with the incorporation, organization, formation, registration and qualification in any jurisdiction of any corporation or other entity, or any subsidiaries thereof, formed for the purpose of purchasing, owning, financing, managing, operating, disposing of or otherwise dealing with any of the assets, liabilities and operations of the Company, or any subsidiary thereof, provided the Manager does not permit such corporation or other entity to take any action described in Section 2.8 without the prior written consent of all the Members; mortgages, notes, deeds, trust indentures and assignments and powers of attorney, consents, waivers and other documents of any character; and pleadings in connection with any proceedings before any court, administrative board or agency of any governmental authority affecting the Company or any of its assets, in each case on such terms as the Manager shall approve;

(iv) execute and deliver on behalf of the Company the Asset Management Agreement and one or more Servicing Agreements;

(v) invest and reinvest funds of the Company in certificates of deposit, commercial paper and other instruments evidencing short-term indebtedness, pending the application thereof in accordance with this Agreement;

(vi) execute and deliver agreements on behalf of the Company, and otherwise act on behalf of the Company in connection with all matters relating to the financing or refinancing of the Company's acquisition of any Pool and the exercise of the Company's rights and the performance of the Company's obligations under any Loan Pool Documentation;

(vii) open, maintain and close bank accounts and to sign checks, such approval to be conclusively, but not exclusively, evidenced by the execution and delivery of any related agreements, instruments or other documents by the Manager;

(viii) vote, give assent and otherwise to exercise all rights, powers, privileges and other incidents of ownership or possession with respect to the Assets or other assets of the Company, and to execute and deliver powers of attorney or proxies to such persons as the Manager shall deem proper, granting to such persons such power and discretion with relation to the Assets or other assets as the Manager shall deem proper;

(ix) subject to the terms of Section 5.6, institute, prosecute, defend, settle, compromise or otherwise adjust all claims and litigation arising out of the conduct of the affairs of the Company or in the enforcement of obligations due the Company, including all rights of appeal;

(x) employ or consult with such agents or independent contractors as the Manager may deem necessary or advisable, including, without limitation, brokers, audi-

tors, counsel, consultants or managers or specialists in any field of endeavor whatsoever, including such persons, firms or companies as may be Members or Affiliates of any Member;

(xi) determine and pay or cause to be paid out of the capital or income of the Company, as the Manager sees fit, all expenses, fees, charges, taxes and liabilities incurred or arising in connection with the conduct of the affairs of the Company, including, but not limited to, expenses and charges for the services of consultants, auditors, counsel, custodians, and such other agents or independent contractors and such other expenses and charges as the Manager may deem necessary or proper to incur, and in general to make all accounting, tax and financial determinations and decisions;

(xii) make allocations and distributions to the Members pursuant to the terms of this Agreement;

(xiii) borrow money and to make, issue, accept, endorse and execute promissory notes, drafts, bills of exchange and other instruments and evidences of indebtedness, and to secure the payment thereof by mortgage, pledge or assignment of, or security interest in, all or any part of the Assets and other property then owned or thereafter acquired by the Company;

(xiv) enter, make and perform such other contracts, agreements and other undertakings as may be necessary or advisable or incidental to the carrying out of any of the foregoing powers, objects or purposes; and

(xv) execute all other instruments of any kind or character and take all action of any kind or character that the Manager may in its sole discretion determine to be necessary or appropriate in connection with the business of the Company.

For the purposes of this Agreement, an "Affiliate" of a person means any other person that directly or indirectly controls, is controlled by or is under common control with, such person or any of its subsidiaries. "Control" (including with correlative meanings the terms "controlling", "controlled by" and "under common control with") means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract or otherwise.

(b) To the extent permitted by law, the Manager may delegate to any person (including, without limitation, the Asset Manager) the power to act in the name and on behalf of the Manager in connection with any particular matter affecting the Company, other than the Manager's right to approve or disapprove Transfers and substitutions of Members in accordance with the terms of Article VII. No delegation of any power pursuant to this Section 2.1(b) shall be deemed to relieve the Manager from any of its duties and obligations to the Company.

(c) Persons dealing with the Company may rely conclusively upon the authority of the Manager under the Delaware Act and as set forth in this Agreement.

2.2 Powers of Members. Except as specifically set forth in this Agreement, none of the Members in their capacities as such shall have the obligation or the right, power or authority to participate in the management, operation or control of the business and affairs of the Company, to transact any business on account thereof, to bind the Company in any way or to sign any obligation, agreement, instrument or any other document for or on behalf of the Company; provided, however, that a Member, an Affiliate of a Member or a principal, member, partner, stockholder, officer, director, agent, representative or employee of a Member or such Affiliate may also be an employee, agent, representative, stockholder, director or officer of, or may contract to render services to, one or both of the Company and the Manager so long as any such arrangement is on terms no less favorable to the Company than would prevail in a comparable arm's length arrangement with a third party.

2.3 Limitation on Manager's Liability. None of the Manager, its Affiliates or their respective principals, members, partners, stockholders, officers, directors, agents representatives, and employees (each, an "Exonerated Person") shall be liable or accountable to the Company or any Member under any circumstances, whether for the return of the capital contributions of a Member or otherwise, except for losses suffered by a Member as a result of the bad faith, fraud, gross negligence or willful misconduct of such Exonerated Person. Without limiting the generality of the foregoing, no Exonerated Person shall be liable or accountable to the Company or a Member for anything done, suffered or omitted in good faith by him or it in accordance with the advice or opinion of any legal counsel or accountant retained by the Company (which may be a legal counsel or accountant for the Manager, its principals, partners or stockholders or their respective Affiliates). In the absence of bad faith, fraud, gross negligence or willful misconduct by an Exonerated Person, such Exonerated Person shall not be liable to the Company or any Member for any act or omission of any independent contractor, employee or agent retained, engaged or employed by the Manager, on behalf of the Manager or the Company, if the Manager exercised reasonable care in the selection of the independent contractor, employee or agent.

2.4 Limitation on Member's Liability. Except as otherwise expressly provided by law, a Member, including the Manager, in its capacity as a Member, shall have no liability in excess of the amounts contributed by it to the Company under Article IV of this Agreement, its share of any assets and undistributed profits of the Company and its obligation to make other payments provided for in this Agreement (subject to the obligation, if any, of a Member, including the Manager, to repay funds wrongfully distributed to it).

2.5 Compensation of Manager. Except for distributions made pursuant to Sections 5.7 or 8.3(d)(iii), the Manager shall not be entitled to any compensation, directly or indirectly, from the Company for its services hereunder in connection with the management of the business and affairs of the Company. Hanover Capital Partners Ltd. will be entitled to receive the Asset Management Fee (as defined in the Asset Management Agreement) as compensation for its services as Asset Manager under the Asset Management Agreement.

2.6 Conflicts of Interest. (a) A Member and its Affiliates and their respective principals, members, partners, stockholders, officers, directors, agents, representatives and employees and all other persons directly or indirectly related to the Member or its Affiliates may engage for their own account in, or possess an interest in, other activities, ventures or

memberships similar or dissimilar to the business of the Company (including, without limitation, those that compete with the Company or its business), and neither the Company nor any other Member shall have any right in or to such activities, ventures or memberships or the income or profits derived therefrom and the pursuit of any such activities, ventures or memberships shall not be deemed to be improper; provided, however, that until such time as the Company shall have drawn down the Maximum Capital Contributions, the Manager agrees to direct to the Company all investment opportunities available to it and/or of which it becomes aware, in each case relating to sub-performing and non-performing mortgage loans on one-to-four family dwellings and/or five-to-eight family residential and mixed use properties and cooperative loans. Subject to Section 2.6(b), a Member or any Affiliate of a Member may lend money to and transact other business with the Company and, to the fullest extent permitted by law, shall have the same rights and obligations with respect thereto as a person or entity who is not a Member or an Affiliate of a Member.

(b) Except with respect to the Asset Management Agreement, for which provision is made in Section 3.1, and the Servicing Agreements, for which provision is made in Section 3.2, any transaction between the Company, on the one part, and any Member and its Affiliates, on the other part, shall be on such terms and conditions as are, on the whole, not less favorable or advantageous to the Company than those available to the Company from reputable, experienced and unrelated persons.

2.7 Indemnification of Manager. To the fullest extent permitted by law, the Company shall indemnify the Manager, its Affiliates and the principals, members, directors, officers, partners, stockholders, agents, representatives and employees of the Manager and its Affiliates, and the independent contractors and agents retained, engaged or employed by the Manager who have acted or are acting on behalf of the Company against, and hold each of them harmless from, any and all damages, losses, liabilities, fines, penalties, amounts paid in settlement, costs and expenses (including attorneys' fees and expenses) actually and reasonably incurred by the indemnified person in connection with any threatened, pending or completed demand, claim, action, suit or proceeding, whether civil, criminal, administrative or investigative, which is or was brought or threatened against any indemnified person by reason of or in connection with actions taken or omitted to be taken by any indemnified person on behalf of the Company in the absence of bad faith, fraud, gross negligence or willful misconduct. Notwithstanding the foregoing, nothing in this Section 2.7 shall be construed to confer upon the Asset Manager or the Servicers or any other person any rights to indemnification by the Company pursuant to the Asset Management Agreement or the Servicing Agreement, respectively, that are not expressly provided thereby. Any indemnity under this Section 2.7 shall be provided out of and to the extent of Company assets only, and no Member shall have any personal liability with respect to the payment of such indemnification obligation.

2.8 Limits on Manager's Powers. Anything in this Agreement to the contrary notwithstanding, the Manager shall not, without the written consent of all the Members, cause or permit the Company to:

(a) do any act which would make it impossible to carry on the ordinary business of the Company;

(b) make any loans to the Manager or its Affiliates;

(c) perform any act that would subject any Member to liability for the obligations of the Company in any jurisdiction;

(d) do business in any jurisdiction which does not recognize the limited liability status of members of a limited liability company;

(e) perform any act that would cause the Company to be taxable as a corporation for federal income tax purposes;

(f) bid on any pool originated by any lender identified by the Manager in a Bid Summary Sheet as having, or otherwise believed by the Manager or any Member to have, engaged in predatory lending practices;

(g) distribute any assets of the Company (other than cash) to the Members in-kind unless such assets are Freely Tradable securities or such distribution is made in connection with a liquidation and dissolution of the Company pursuant to Article VIII hereof; or

(h) make any bid for, or purchase, any assets, whether directly or indirectly through a corporation or other entity formed by the Manager, that are not sub-performing or non-performing mortgage loans on one-to-four family dwellings and/or five-to-eight family residential and mixed use properties or cooperative loans, except that any corporation or other entity formed by the Manager pursuant to Section 2.1(a)(iii) may purchase real property through a foreclosure, power of sale or deed-in-lieu of foreclosure carried out and/or signed pursuant to the documents securing any loan owned by the Company (or by any corporation or other entity formed by Manager pursuant to Section 2.1(a)(iii)).

ARTICLE III

ASSET MANAGEMENT AND SERVICING

3.1 Asset Management Agreement. The Company has selected, and hereby reaffirms the selection of, Hanover Capital Partners Ltd. as the Asset Manager pursuant to, and in accordance with, the terms and conditions of the Asset Management Agreement. The Members hereby approve such selection. The Manager, on behalf of the Company, has the right to direct the Asset Manager in connection with the performance of its duties under the Asset Management Agreement. If any "Event of Default" under and as defined in Section 5.1(a) of the Asset Management shall occur, the Manager shall promptly notify each Member and take such actions with respect thereto (including, but not limited to, removing and replacing the Asset Manager) as directed by the Required Members.

3.2 Servicing Agreements. The Manager intends to select The Provident Bank to act as the Servicer for one or

more Pools. The Manager may select other Servicers for one or more Pools with the consent of the Required Members. The Manager, on behalf of the Company, shall have the right to terminate the engagement of any Servicer as Servicer under the applicable Servicing Agreement and appoint a successor Servicer thereunder (or to terminate the Servicing Agreement and cause the Company to enter into a successor servicing agreement with a successor servicer), and in each case shall take such actions from time to time as directed by the Required Members.

ARTICLE IV

CAPITAL CONTRIBUTIONS; INCOME NOTES; CAPITAL ACCOUNTS

4.1 Membership Interests. A Member's "Membership Interest" means the entire ownership interest of such Member in the Company, including its limited liability company interest in the Company and any and all rights, powers and benefits accorded to a Member under this Agreement and the duties and obligations of such Member hereunder. A Member's Membership Interest shall entitle such Member to a Sharing Percentage with respect to the income and losses in respect of each Pool. A Member's Sharing Percentage with respect to any Pool shall mean, at any time, the ratio (expressed as a percentage) of (1) such Member's Capital Contributions allocable to such Pool at such date to (2) the total Capital Contributions of all Members allocable to such Pool at such date.

4.2 Capital Contributions. (a) Simultaneously with the execution of the Original Agreement, each Member made an initial Capital Contribution to the Company of cash in the amount set forth under "Initial Capital Contribution" opposite such Member's name in Exhibit A hereto.

(b) The Manager will notify each Member within two (2) business days following the date on which it becomes aware of any prospective Pool available for bid. If non-binding indicative bids are requested, the Manager shall discuss the proposed bid methodology with each Member and request direction from each such Member regarding whether or not to submit an indicative, non-binding bid. At least three (3) business days prior to the submission of any binding bid by the Company in respect of a Pool, the Manager shall deliver to each Member a bid summary sheet ("Bid Summary Sheet"), which sets forth the reasoning, methodology, calculations and due diligence findings (which findings shall include a determination of (i) whether the acquisition of such prospective Pool would require the Company to obtain any Governmental Authorization of or from any applicable Governmental Body that is required pursuant to any Legal Requirement, and, (ii) if determined to be applicable by any Member in its sole discretion, whether the seller of such prospective Pool has failed to obtain any Governmental Authorization of or from any applicable Governmental Body that is required pursuant to any Legal Requirement, or is or at any time was otherwise in violation of any applicable Legal Requirement, that in either case would result in potential liability or loss for the purchaser of such Pool) of the Asset Manager and the Manager in respect of such bid and, if applicable, shall include a notification to the Member if the Manager has knowledge, or otherwise believes, that the originator of any assets in such Pool has engaged in predatory lending practices. Each

Member shall have the right, but not the duty, to inspect, inquire, comment on and participate in such bid analysis. Each Member shall have the right to elect to participate or not to participate in any Pool proposed to be acquired by the Company in such Member's sole discretion. Each Member shall be required to notify the Manager of its election to participate or not participate in any Pool not later than 3:00 p.m. (New York time) on the business day proceeding the bid deadline date for such Pool. In connection with and not later than the date of each closing of the Company's acquisition of a Pool, the Members that have elected to participate in such Pool shall make additional Capital Contributions to fund such purchase and any costs and expenses relating to such purchase by acquiring from the Company income notes, which shall be in the form of Exhibit C hereto (the "Income Notes"). The aggregate purchase price payable by the Members for the Income Notes relating to any Pool will be equal to the purchase price payable by the Company for such Pool, together with any costs and expenses of the Company relating to such Pool, less the amount of any third party financing arranged by the Manager in respect of the acquisition of such Pool. Such aggregate Income Note purchase price shall be paid in cash by the Members that have elected to participate in such Pool pro rata based upon (a) if all of the Members have elected to participate in such Pool, their respective Percentage Interests (which are set forth on Exhibit A hereto) or (b) if less than all of the Members have elected to participate in such Pool, the ratio of (x) the Percentage Interest of each such Member that has elected to participate in such Pool to (y) the aggregate Percentage Interests of all such Members who have elected to participate in such Pool. No Member shall be required to purchase Income Notes relating to, or otherwise make a Capital Contribution to fund the purchase price of, any Pool as to which such Member has not elected to participate. No Member shall be required to purchase Income Notes, or otherwise make a Capital Contribution to fund the purchase price of any Pool, subsequent to the expiration of the Investment Period.

(c) Subject to the Maximum Capital Contribution limit of each Member, the Manager may require the Members from time to time to contribute additional capital to the Company pursuant to this Section 4.2(c) in such aggregate amounts as in each case the Manager shall determine, for payment of, or reimbursement to the Manager for, the costs, expenses, liabilities and other obligations referred to in Section 6.1 (including, but not limited to, payments of principal and interest under the Loan Pool Documentation). The Members shall make such additional Capital Contributions in cash in proportion to each such Member's Percentage Interest; provided that if any such cost, expense or liability is allocable to a particular Pool and not to the Company generally, such additional Capital Contributions shall be made in proportion to each Member's Sharing Percentage in respect of such Pool.

(d) The Manager may require the Members to make Capital Contributions pursuant to this Section 4.2 by giving notice to the Members by telephonic, facsimile or other electronic communication, with written confirmation to follow promptly thereafter. The notice shall specify (i) the place at which the Capital Contributions are to be made, (ii) the aggregate amount of the Capital Contributions to be made by all Members and the amount of the Capital Contribution to be made by each Member in accordance with Sections 4.2(a), (b) or (c) above, as applicable, (iii) the time at which the Capital Contributions are to be made, which time shall not be earlier than 9:00 a.m., New York time, on the third business day after the initial giving of the notice and (iv) the use or uses to which the Manager proposes to apply the Capital Contributions.

(e) Except as provided in this Section 4.2, no Member shall have an obligation to make any Capital Contribution to the Company, including, without limitation, any obligation to eliminate any deficit in the Member's Capital Account. No person other than the Manager (including, without limitation, any of the other Members and the creditors of the Company or the Members) shall have any right to cause any Member to contribute any capital to the Company pursuant to this Section 4.2 or otherwise. A Member shall not be required to lend any funds to the Company.

(f) As used herein, "Capital Contribution" shall mean, with respect to any Member, the cash or other property contributed by such Member from time to time to the capital of the Company, including in any event the purchase price of any Income Notes acquired by such Member in connection with the acquisition of any Pool. No Member shall be required to make Capital Contributions hereunder in excess of such Member's Maximum Capital Contribution at any time. The Members agree that Capital Contributions may be advanced, paid and re-advanced from time to time.

(g) It is the intent of the Company, the Manager and each Member that, for Federal, state and local income tax purposes, the Income Notes will evidence an equity or ownership interest in the Company and will not evidence indebtedness of the Company. Each Member, by its execution of this Agreement and acceptance of an Income Note, agrees to treat such Income Note for purposes of Federal, state and local income taxes, and any other tax imposed on or measured by income, as an equity or ownership interest in the Company.

4.3 Interest on Capital. No interest shall be paid on any capital contributed to the Company.

4.4 Return of Capital Contribution. Except as otherwise expressly provided in this Agreement (including, but not limited to, as provided in Section 5.7 hereof), no Member shall have the right to demand the return of all or any part of any Capital Contribution until the Company has been dissolved and then only to the extent provided in Article VIII hereof, and no Member shall have the right to demand or receive property other than cash in return for its Capital Contribution or to have priority over another Member, either as to the return of Capital Contributions or as to profits, losses or distributions, or as to compensation by way of income.

4.5 Capital Accounts. A separate capital account ("Capital Account") shall be maintained for each Member in accordance with Treasury Regulations Section 1.704-1(b)(2). Without limiting the foregoing, each Member's Capital Account shall be credited with the sum of (i) the amount of money and fair market value of property contributed by such Member to the Company, including the purchase price of any Income Notes acquired pursuant to Section 4.2(b), but net of liabilities assumed by the Company or which such property is taken subject to, (ii) allocations to such Member of its allocable share of Net Income and (iii) the amount of income or profits, if any, allocated to such Member not otherwise taken into account in this Section 4.5. Each Member's Capital Account shall be decreased by the sum of (x) the amount of money distributed to such Member and the fair market value of property distributed to such Member (net of liabilities assumed by such Member or which such property is taken subject to), (y) allocations to such Member of its allocable share of Net Losses and (z) the amount of

expenses or losses, if any, allocated to such Member not otherwise taken into account in this Section 4.5. If any property other than cash is distributed to a Member, the Capital Accounts of the Members shall be adjusted as if the property had instead been sold by the Company for a price equal to its Gross Asset Value and the proceeds distributed. Upon liquidation and dissolution of the Company, any unsold Company property shall be valued at its fair market value to determine the gain or loss which would result if such property were sold at the time of such liquidation. The Capital Accounts of the Members shall be adjusted to reflect how any such gain or loss would have been allocated under Article V if such property had been sold at the assigned values. The foregoing provisions and the other provisions of this Agreement relating to the maintenance of Capital Accounts are intended to comply with the provisions of Treasury Regulations Section 1.704-1(b)(2) and shall be interpreted in a manner consistent with such Treasury Regulations. The Capital Accounts of the Members shall be increased or decreased in accordance with Regulations Section 1.704-1(b)(2)(iv)(f) to reflect a revaluation of the property of the Company on the Company's books at the times set forth in paragraph (b) of the definition of "Gross Asset Value." The Capital Account of any Member shall carry over to the transferee of any Member in proportion to the Membership Interest transferred.

ARTICLE V

ALLOCATIONS; DISTRIBUTIONS

5.1 Allocations of Net Income and Losses. Except as otherwise provided in this Agreement, Net Income and Net Losses of the Company for each Fiscal Year shall be allocated among the Members in a manner such that, as of the end of such Fiscal Year and taking into account all prior allocations of Net Income and Net Losses of the Company and all distributions made by the Company through such date, the Capital Account of each Member is, as nearly as possible, equal to the distributions that would be made to such Member pursuant to Section 5.7(a) if the Company were dissolved, its affairs wound up and assets sold for cash equal to their value, all Company liabilities were satisfied, and the net assets of the Company were distributed in accordance with Section 5.7(a) immediately after such allocation.

5.2 Limitation on Loss Allocation. Losses allocated to a Member pursuant to Section 5.1 shall not exceed the maximum amount of losses that can be allocated without causing a Member to have an Adjusted Capital Account Deficit at the end of any Fiscal Year. In the event that any Member would have an Adjusted Capital Account Deficit as a consequence of an allocation of losses pursuant to Section 5.1, the amount of losses that would be allocated to such Member but for the application of this Section 5.2 shall be allocated to the other Members to the extent that such allocations would not cause such Members to have an Adjusted Capital Account Deficit and allocated among such Members in proportion to their total Capital Contributions. Any allocation of items of loss pursuant to this Section 5.2 shall be taken into account in computing subsequent allocations pursuant to Section 5.1, and prior to any allocation of items in such Section so that the net amount of any items allocated to each Member pursuant to Section 5.1 and this Section 5.2 shall, to the maximum extent practicable, be equal to the net amount that would have been allocated to each Member pursuant to the provisions of Section 5.1 and this Section 5.2 if such allocation under this Section 5.2 had not occurred.

5.3 Special Allocations. Notwithstanding any of the provisions set forth above in this Article V to the contrary, the following special allocations shall be made in the following order:

(a) Minimum Gain Chargeback. If there is a net decrease in Company Minimum Gain during any Fiscal Year, each Member shall be specially allocated items of Company income and gain for such Fiscal Year (and, if necessary, subsequent Fiscal Years) in an amount equal to such Member's share of the net decrease in Company Minimum Gain, determined in accordance with Treasury Regulations Section 1.704-2(g). Allocations pursuant to the previous sentence shall be made in proportion to the respective amounts required to be allocated to each Member pursuant thereto. The items to be so allocated shall be determined in accordance with Treasury Regulations Section 1.704-2(f)(6) and Section 1.704-2(j)(2). This Section 5.3(a) is intended to comply with the minimum gain chargeback requirement in Treasury Regulations Section 1.704-2(f) and shall be interpreted consistently therewith. To the extent permitted by such Treasury Regulations and for purposes of this Section 5.3(a) only, each Member's net decrease in Company Minimum Gain shall be determined prior to any other allocations pursuant to this Article V with respect to such Fiscal Year.

(b) Member Minimum Gain Chargeback. Notwithstanding any other provision of this Article V, except Section 5.3(a), if there is a net decrease in Member Minimum Gain attributable to Member Nonrecourse Debt during any Fiscal Year, each Member that has a share of the Member Minimum Gain attributable to such Member Nonrecourse Debt, determined in accordance with Treasury Regulations Section 1.704-2(i)(5), shall be specially allocated items of Company income and gain for such Fiscal Year (and, if necessary, subsequent Fiscal Years) in an amount equal to such Member's share of the net decrease in Member Minimum Gain attributable to such Member Nonrecourse Debt, determined in accordance with Treasury Regulations Section 1.704-2(i)(4). Allocations pursuant to the previous sentence shall be made in proportion to the respective amounts required to be allocated to each Member pursuant thereto. The items to be so allocated shall be determined in accordance with Treasury Regulations Section 1.704-2(i)(4) and Section 1.704-2(j)(2)(ii). This Section 5.3(b) is intended to comply with the minimum gain chargeback requirement in Treasury Regulations Section 1.704-2(i)(4) and shall be interpreted consistently therewith. Solely for purposes of this Section 5.3(b), each Member's net decrease in Member Minimum Gain shall be determined prior to any other allocations pursuant to this Article V with respect to such Fiscal Year, other than allocations pursuant to Section 5.3(a).

(c) Qualified Income Offset. In the event that any Member unexpectedly receives any adjustments, allocations or distributions described in Treasury Regulations Section 1.704-1(b)(2)(ii)(d)(4), (5) or (6), items of Company income and gain shall be specifically allocated to each such Member in an amount and manner sufficient to eliminate, to the extent required by the Treasury Regulations, the Adjusted Capital Account Deficit of such Member as quickly as possible, provided that an allocation pursuant to this Section 5.3(c) shall be made if and only to the extent that such Member would have an Adjusted Capital Account Deficit after all other allocations provided for in this Article V have been tentatively made as if this Section 5.3(c) were not in this Agreement. The foregoing provision is intended to comply with Treasury Regulations Section 1.704-1(b)(2)(ii)(d) and shall be interpreted and applied in a manner consistent with such Treasury Regulations.

(d) Gross Income Allocation. In the event that any Member has an Adjusted Capital Account Deficit at the end of any Fiscal Year, then each such Member shall be specially allocated items of Company income and gain as quickly as possible, provided that an allocation pursuant to this Section 5.3(d) shall be made only if and to the extent that such Member would have an Adjusted Capital Account Deficit after all other allocations provided for in this Article V have been tentatively made as if this Section 5.3(d) were not in this Agreement.

(e) Nonrecourse Deductions. Nonrecourse Deductions for any Fiscal Year will be allocated to the Members in the same manner in which such items would have been allocated pursuant to Section 5.1(b).

(f) Member Nonrecourse Deductions. Any Member Nonrecourse Deductions for any Fiscal Year or other period shall be specially allocated to the Member who bears the economic risk of loss with respect to the Member Nonrecourse Debt to which such Member Nonrecourse Deductions are attributable in accordance with Treasury Regulations Section 1.704-2(i).

(g) Code Section 754 Adjustment. To the extent an adjustment to the adjusted tax basis of any Company asset pursuant to Code Section 734(b) or Code Section 743(b) is required, pursuant to Treasury Regulations Section 1.704-1(b)(2)(iv)(m)(2) or Treasury Regulations Section 1.704-1(b)(2)(iv)(m)(4), to be taken into account in determining Capital Accounts as the result of a distribution to a Member in complete liquidation of its interest in the Company, the amount of such adjustment to the Capital Accounts shall be treated as an item of gain (if the adjustment increases the basis of the asset) or loss (if the adjustment decreases such basis) and such gain or loss shall be specially allocated to the Members in a manner consistent with the manner in which their Capital Accounts are required to be adjusted pursuant to such Treasury Regulations Section.

(h) Curative Allocations. It is the intent of the Members that, to the extent possible, the allocations set forth in the foregoing provisions of this Section 5.3 will be offset with special allocations of other items of Company income, gain, loss, and deduction pursuant to this Section 5.3(h). Therefore, notwithstanding any other provision of this Article V (other than Section 5.3 hereof), the Manager shall make such offsetting special allocations of Company income, gain, loss, or deduction in whatever manner the Manager determines to be appropriate so that, after such offsetting allocations are made, each Member's Capital Account balance is, to the extent possible, equal to the Capital Account balance such Member would have had if the allocations set forth in the foregoing provisions of this Section 5.3 were not part of this Agreement. In exercising its discretion under this Section 5.3(h), the Manager shall take into account future allocations under Sections 5.3(a) and 5.3(b) that, although not yet made, are likely to offset other allocations previously made under Sections 5.3(e) and 5.3(f).

5.4 Tax Incidents. It is intended that the Company will be treated as a pass-through entity for tax purposes. Subject to Section 704(c) of the Code, for U.S. federal and state income tax purposes, all items of Company income, gain, loss, deduction, credit and any other allocations not otherwise provided for shall be allocated among the Members in the same manner as the corresponding item of income, gain, loss or deduction was allocated pursuant to the preceding Sections of this Article V.

5.5 Section 704(c) Allocations. In accordance with Section 704(c) of the Code and the Treasury Regulations thereunder, income, gain, loss and deduction with respect to any property contributed to the capital of the Company shall, solely for tax purposes, be allocated among the Members so as to take account of any variation between the adjusted tax basis of such property to the Company for federal income tax purposes and its fair market value at the time of contribution. Any elections or decisions relating to such allocations shall be made by the Tax Matters Member in a manner that reasonably reflects the purpose and intention of this Agreement. Allocations pursuant to this Section 5.5 are solely for purposes of federal, state and local taxes and shall not affect, or in any way be taken into account in computing, any Member's Capital Account or share of Net Income, Net Losses or other items or distributions pursuant to any provision of this Agreement.

5.6 Tax Matters Member; Tax Elections. The Manager shall be the "tax matters partner" of the Company as defined in Code Section 6231(a)(7) (the "Tax Matters Member") and has and shall have all the powers and obligations of a tax matters partner pursuant to the Code. All elections, filings and determinations required or permitted to be made by the Company under the tax laws of the United States, the several States or any other relevant jurisdiction shall be timely determined and made by the Manager; provided, that the Manager shall not make any such election or determination without obtaining the consent of each Member (such consent not to be unreasonably withheld or delayed).

5.7 Distributions of Distributable Cash. Subject to Section 8.3(d), Distributable Cash with respect to a Disposition of all or a portion of a Pool shall be distributed to the Members at such times as the Manager deems appropriate in its sole discretion but in any event within 10 business days after receipt thereof by the Company provided that Distributable Cash representing the scheduled payment of principal or interest on Assets included in a Pool and/or the payment of interest on temporary investments will be retained by the Manager and distributed to the Members monthly. Distributable Cash received by the Company with respect to a Pool shall be distributed in the following amounts and order of priority among the Members in proportion to their respective Sharing Percentages (determined at a time immediately prior to such distribution) with respect to the Pool generating such Distributable Cash:

(i) First, the portion of each Member's Sharing Percentage of such distribution shall be distributed to such Member to the extent required so that such Member has been distributed an amount equal to such Member's unreturned Capital Contributions (determined immediately prior to such distribution) allocable to such Pool (each such distribution reducing such Member's unreturned Capital Contributions attributable to such Pool by the amount so distributed);

(ii) Second, the portion of each Member's Sharing Percentage of such distribution remaining after the application made to such Member pursuant to clause (i) shall be distributed to such Member to the extent required so that such Member has been distributed an amount equal to such Member's unreturned Capital Contributions used to fund any expenses which are not directly allocable to any Pool;

(iii) Third, the portion of each Member's Sharing Percentage of such distribution remaining after the application made to such Member pursuant to clauses (i) and (ii) shall be distributed to such Member to the extent required so that the cumulative amount distributed to such Member under this clause (iii) in the current Fiscal Year and all prior Fiscal Years equals a 13% per annum rate of return on all Capital Contributions made by such Member allocable to such Pool (or otherwise referred to in clause (ii)), in each case accruing from the date on which such Member actually made such Capital Contributions;

(iv) Fourth, the portion of such Member's Sharing Percentage of such distribution remaining after the foregoing applications shall be distributed 70% to the Manager and 30% to such Member until the cumulative amount distributed to the Manager under this clause (iv) in the current Fiscal Year and all prior Fiscal Years equals 20% of the sum of (1) the aggregate amount of all distributions to such Member pursuant to clause (iii) above and this clause (iv), in each case that are allocable to such Pool, and (2) the aggregate amount of all distributions to the Manager pursuant to this clause (iv) that are allocable to such Pool;

(v) Fifth, any remaining amounts distributable to such Member shall be distributed 80% to such Member and 20% to the Manager until such time as the cumulative amount distributed to such Member under this clause (v) and the foregoing clauses (iii) and (iv) in the current Fiscal Year and all prior Fiscal Years, in each case allocable to such Pool, equals a 35% per annum rate of return on all Capital Contributions made by such Member allocable to such Pool; and

(vi) Sixth, any remaining amounts distributable to such Member shall be distributed 75% to such Member and 25% to the Manager.

5.8 Distributions In-Kind. It is the intent that all distributions made under this Agreement be in cash, except as specifically provided herein and in Section 8.3(d). Except in connection with the dissolution and liquidation of the Company, the Manager may only make in-kind distributions to the Members that consist of securities which are Freely Tradable; provided that it will not make any such distribution to a Member if it has received written notice from such Member (which may be specific or general) that such Member would violate existing law applicable to it if it received same. In the event that a distribution of assets is made, such assets shall be deemed to have been sold at their Gross Asset Value, and the proceeds of such sale shall be deemed to have been distributed to the Member as Distributable Cash, for all purposes of this Agreement. Subject to Section 8.3(d), assets distributed in-kind shall be distributed in proportion to the aggregate amounts that would be distributed to each Member pursuant to Section 5.7, and if a distribution consists of both cash and assets or assets of more than one class, each Member receiving the distribution shall, except to the extent necessary to avoid fractional interests, receive the same proportion of cash and assets of each class being distributed. The Manager may cause certificates evidencing any assets to be distributed in-kind to be imprinted with legends as to such restrictions on transfer that it may deem necessary or appropriate, including legends as to applicable United States or non-U.S. securities laws or other legal or contractual restrictions, and may require any Member to which assets are to be distributed in-kind to agree in writing (a) that

such assets will not be transferred except in compliance with such restrictions and (b) to such other matters as the Manager may deem necessary or appropriate.

ARTICLE VI

FINANCIAL MANAGEMENT

6.1 Costs, Expenses, Liabilities and Obligations. The Company shall pay, or reimburse the Manager for, all reasonable out-of-pocket costs, expenses, liabilities and other obligations incurred, suffered or paid in connection with the formation of the Company (including, without limitation, the negotiation and preparation of this Agreement, the Asset Management Agreement, the Servicing Agreements and any Loan Pool Documentation), the purchase of, or bid or potential bid for (whether or not any such bid is made or accepted), any Assets, the management and operation of the business and affairs of the Company and the accomplishment of its purposes in accordance with the terms of this Agreement, including but not limited to, the payment of amounts owing from time to time to the Asset Manager under the Asset Management Agreement, the lenders under any Loan Pool Documentation or any Servicer under the Servicing Agreements. The Company also may fund a reserve for the payment of the foregoing costs, expenses, liabilities and other obligations in such amount as the Manager may in the absence of bad faith determine from time to time. In no event will the amounts subject to payment or reimbursement by the Company hereunder include the ordinary course operating costs or expenses of the Manager or the Asset Manager (e.g. salaries, rent, utilities, data processing expenses, etc.).

6.2 Books and Records. The Manager shall maintain full and accurate books of the Company, showing all receipts and expenditures, assets and liabilities, profits and losses, and all other records necessary for recording the business and affairs of the Company. The books of the Company shall be kept on an accrual basis. Such books and records shall be open to the inspection and examination of the Members and by their duly authorized representatives at reasonable times.

6.3 Fiscal Year. The Fiscal Year of the Company shall be the calendar year.

6.4 Reports. The Manager shall prepare or cause to be prepared and shall furnish to each Member copies of a balance sheet, a statement of revenue and expenses and a statement of each Member's share of the Net Income or Losses of the Company as at the end of and for each of the first three calendar quarters of each fiscal year of the Company and as at the end of and for each fiscal year of the Company. Quarterly statements need not be audited and shall be furnished within 60 days after the end of each calendar quarter; annual statements shall be audited by a nationally recognized firm of independent public accountants acceptable to the Manager and shall be furnished within 90 days after the end of each fiscal year of the Company. The Manager shall cause the Members to receive necessary income tax reporting information by March 30 of each year. The Manager also shall furnish to a Member such other reports on the operations and condition of the Company as may be reasonably requested by the Member, and as may be available to the Manager. All of the costs and expenses of preparing and furnishing such statements and reports shall be costs and expenses of the Company and not of the Manager.

6.5 Bank Accounts and Investment of Funds. All funds of the Company, pending the application thereof in accordance with this Agreement, shall be deposited in its name in such checking and savings accounts or shall be invested in such certificates of deposit, commercial paper and other instruments evidencing short-term obligations, as shall be designated by the Manager.

6.6 Accounting Decisions. All decisions as to accounting principles and procedures, except as specifically provided to the contrary herein, shall be made by the Manager.

6.7 Income Tax Returns and Elections. The Manager, for the Company, shall file any and all Federal, state, local and foreign tax returns necessary to be filed by the Company and in such manner as will effectuate the tax treatment described in this Agreement. Such tax returns shall be prepared by such nationally recognized firm of independent public accountants as shall be selected by the Manager from time to time and approved by the Members. Each Member agrees to report on its own tax returns items pertaining to the Company in a manner consistent with the terms of this Agreement. All costs incurred in connection with the activities described in this Section 6.7, including legal and accounting costs, shall be Company expenses payable pursuant to Section 6.1.

ARTICLE VII

TRANSFERS BY MEMBERS; SUBSTITUTE MEMBERS

7.1 Transfers by Members. (a) Without the prior written consent of the Manager, which consent shall not be unreasonably withheld, no Member may resign or withdraw from the Company or Transfer all or any portion of its Membership Interest or any Income Notes held by it unless such Transfer is made to an Affiliate of such Member. No Transfer of all or any portion of a Membership Interest or any Income Note shall be made unless the transferee shall have executed a written acknowledgment to the effect set forth in Section 4.2(g). The Manager shall register on the books of the Company any permitted Transfer by a Member of its Membership Interest in the Company pursuant to this Section 7.1(a).

(b) Notwithstanding anything to the contrary contained in this Agreement, including any provision of this Article VII, a Member may Transfer all or any portion of its Membership Interest and any Income Notes held by it to any person or entity, without the consent of the Manager, any other Member, or any other person or entity, if (i) the Company engages in (A) any activity that would result in a violation of federal or state banking law, including, without limitation, laws applicable to FDIC-insured depository institutions and the rules, regulations and interpretations of the FDIC, with respect to such Member, or (B) any activity that is not part of, or incidental to, the business of banking, as determined by the FDIC or the OCC, or (ii) such Member is required to Transfer all or any portion of its Membership Interest by a competent regulatory authority having jurisdiction over such Member or any of its Affiliates or pursuant to any law or regulation applicable to such Member or any of its Affiliates.

(c) To the fullest extent permitted by law, any purported Transfer of any Membership Interest or Income Notes in contravention of this Article VII shall be null and void and of no force and effect whatsoever.

7.2 Substitute Members. (a) An assignee of a Membership Interest shall become a substitute Member only with the prior written consent of the Manager, which consent shall not be unreasonably withheld, and the Required Members; provided that any assignee of all or any portion of a Member's Membership Interest pursuant to Section 7.1(b) shall be admitted to the Company as a Substitute Member without the consent of the Manager or any other Person.

(b) An assignee of a Membership Interest in the Company that is not admitted as a substitute Member shall be entitled only to allocations and distributions with respect to that Membership Interest in accordance with this Agreement but shall have no right to any information or accounting of the affairs of the Company and, except as otherwise agreed by the other Members, shall not have any of the other rights of a Member under this Agreement.

(c) An assignee of a Membership Interest in the Company shall be admitted as a substitute Member in accordance with this Section 7.2 at the time such assignee's admission is reflected in the records of the Company. A substitute Member admitted to the Company shall succeed to all the rights and be subject to all the obligations of the assignor Member under this Agreement in respect of the interest as to which it was substituted and, to the fullest extent permitted by law, the assignor Member shall be released from its obligations under this Agreement with respect to such interest.

ARTICLE VIII

DISSOLUTION, LIQUIDATION AND TERMINATION

8.1 Limitations. The Company may be dissolved, liquidated and terminated pursuant to and only pursuant to the provisions of this Article VIII, and the parties hereto do hereby irrevocably waive any and all other rights they may have to cause a dissolution of the Company or a sale or partition of any or all of the Company's assets.

8.2 Exclusive Causes. The Company shall be dissolved, and liquidated pursuant to Section 8.3, upon the earliest to occur of (it being understood that the following events are the only events that can cause the dissolution and liquidation of the Company):

(a) following the expiration of the Investment Period, upon the liquidation of all Assets, temporary investments and other assets of the Company;

(b) the unanimous election by the Members so to dissolve the Company;

(c) the good faith determination by the Manager that dissolution is necessary or advisable to avoid violations of the Investment Company Act or the Employee Retirement Income Security Act of 1974, as amended ("ERISA");

(d) at any time there are no Members of the Company unless the business of the Company is continued in accordance with the Delaware Act; or

(e) the entry of a decree of judicial dissolution pursuant to Section 18-802 of the Delaware Act.

8.3 Liquidation. In all cases of dissolution of the Company, the business of the Company shall be continued to the extent necessary to allow an orderly winding up of its affairs, including the liquidation of the assets of the Company pursuant to the provisions of this Section, as promptly as practicable thereafter, and each of the following shall be accomplished:

(a) The Manager shall cause to be prepared a statement setting forth the assets and liabilities of the Company as of the date of dissolution, a copy of which statement shall be furnished to all of the Members.

(b) The property of the Company shall be liquidated or distributed in kind by the Manager as promptly as possible, but in an orderly, businesslike and commercially reasonable manner. The Manager may, in the exercise of his business judgment and if commercially reasonable, determine (i) to sell all or any portion of the property of the Company to a Member, provided that the purchase price is not less than the fair market value of such property as determined in the sole discretion of the Manager or its designee, or to any other Person or (ii) not to sell all or any portion of the property of the Company, in which event such property and assets shall be distributed in kind pursuant to Section 8.3(d).

(c) Any gain or loss realized by the Company upon the sale of its property shall be deemed recognized and allocated to the Members in the manner set forth in Article V. To the extent that an asset is to be distributed in kind, such asset shall be deemed to have been sold at its fair market value on the date of distribution, the gain or loss deemed realized upon such deemed sale shall be allocated in accordance with Article V and the amount of the distribution shall be considered to be such fair market value of the asset.

(d) The proceeds of sale and all other assets of the Company shall be applied and distributed as follows and in the following order of priority:

(i) to the satisfaction (whether by payment or reasonable provision for payment) of the debts and liabilities of the Company and the expenses of liquidation or distribution;

(ii) the balance, if any, to the Members having positive Capital Account balances (after all adjustments thereto otherwise required hereunder) proportionately to their respective positive Capital Account balances (as so adjusted), with the intent that such distribution be effected in accordance with Section 5.7(a).

The Manager may establish any reserves which the Manager shall determine to be reasonably necessary for contingent conditional or unmatured liabilities or obligations of the

Company. Such reserves may, in the discretion of the Manager, be held by the Manager or paid over to a bank or trust company selected by it, in either case to be held by the Manager or such bank or trust company as escrow holder or liquidating trustee for the purposes of disbursing such reserves to satisfy the liabilities and obligations described above. Such reserves shall be held for such period as the Manager shall deem advisable, and upon the expiration of such period, any remaining balance shall be distributed as provided in clause (ii) of this subsection.

8.4 Continuation of the Company. Notwithstanding anything to the contrary contained herein, the death, retirement, resignation, expulsion, bankruptcy, dissolution or removal of a Member shall not in and of itself cause the dissolution of the Company, and the Members are expressly authorized to continue the business of the Company in such event, without any further action on the part of the Members. The bankruptcy (as defined in the Delaware Act) of a Member shall not cause a Member to cease to be a member of the Company unless all Members other than such bankrupt Member otherwise agree in writing at any time while such bankrupt Member is in bankruptcy (as defined in the Delaware Act) that such bankrupt Member shall cease to be a member of the Company.

ARTICLE IX

ATTORNEY-IN-FACT

Each Member and its successors and assigns irrevocably constitutes and appoints the Manager, and each of them, as its true and lawful attorneys, in its name, place and stead, to make, execute, consent to, swear to, acknowledge, record and file:

(i) a certificate of formation and the applicable laws of any other jurisdiction in which the Manager deems such filing to be necessary or desirable;

(ii) any and all certificates, instruments and other documents which may be required to be filed by the Company or the Members under the laws of the State of Delaware or any other jurisdiction to the extent that the Manager deem such filing to be necessary or desirable to qualify the Company to engage in its business or otherwise facilitate the Company's business;

(iii) any and all amendments or modifications of the instruments described in paragraphs (i) and (ii) above;

(iv) all certificates, instruments and other documents which may be required to effectuate the dissolution and termination of the Company pursuant to the provisions of this Agreement;

(v) any and all duly adopted amendments to this Agreement, including any amendments and other documents deemed, necessary or desirable by the Manager for the admission of substituted Members, when consented to hereunder; and

(vi) any and all fictitious name certificates or similar certificates required by law to be filed on behalf of the Company;

and each Member hereby irrevocably constitutes and appoints the Manager as its true and lawful attorney, in its name, place and stead, to take any and all such other action as the Manager may deem necessary or desirable fully to carry out the provisions of this Agreement in accordance with its terms. It is expressly understood and intended by each Member that the grant of the foregoing power of attorney is coupled with an interest and shall be irrevocable. The foregoing power of attorney shall, if a Member shall have assigned its interest, or any part thereof, in the Company, survive such assignment of such interest or part thereof.

ARTICLE X

REPRESENTATIONS AND WARRANTIES

10.1 Securities Law Representations. Each Member represents

that:

(a) The Member has acquired its interest in the Company for its own account and not with a view to the resale or distribution thereof.

(b) The Member is an "accredited investor" as defined in Rule 501(a) under the Securities Act.

(c) The Member understands and acknowledges that its interest in the Company has not been registered for sale under any Federal or state securities law and must be held indefinitely unless subsequently registered or an exemption from such registration is available.

(d) The Member (i) has performed its own due diligence and business investigations with respect to the Company, (ii) has formed its own conclusions regarding the conditions and values of the business, assets, liabilities and prospects of the Company, and is not relying upon any other Member or other person with respect to the performance of such investigations or the evaluation of such conditions or values, (iii) is fully familiar with the nature of the investment in the Company, the speculative and financial risks thereby assumed, the uncertainty with respect to the timing and amounts of distributions, if any, to be made by the Company, (iv) does not desire any further information which may be available with respect to these matters and (v) had a sufficient opportunity to review the matters that it believes to be important in deciding whether to acquire an interest in the Company.

(e) The Member (i) is not an "investment company" as defined in the Investment Company Act, (ii) is able to satisfy its obligations (including its financial obligations) under this Agreement from existing commitments of the current holders of its equity interests; and (iii) constitutes a single "beneficial owner" for purposes of the Investment Company Act.

10.2 Other Representations and Warranties. Each Member represents and warrants that:

(i) If the Member is a corporation, it is duly incorporated, validly existing and in good standing under the laws of the jurisdiction of its incorporation and has all necessary corporate power and authority to execute and deliver this Agreement; if the Member is a partnership, it is duly and validly organized under the laws of its jurisdiction and has all necessary partnership power and authority to execute and deliver this Agreement.

(ii) The execution and delivery by it of this Agreement and the performance by it of its obligations under this Agreement have been duly authorized by all necessary corporate or partnership action by it or on its behalf and do not and will not violate, result in a breach of or constitute a default under, its articles or certificate of incorporation or bylaws or its certificate of limited partnership or agreement of limited partnership or its partnership agreement, as the case may be.

(iii) No authorization, consent, approval or waiver of, clearance by, notice or registration or filing with, or other similar action by or with any governmental body or other person is required on the part of the Member for (i) the due execution and delivery by the Member of this Agreement or (ii) the performance by the Member of its obligations under this Agreement.

(iv) This Agreement is the legal, valid and binding obligation of the Member, enforceable against it in accordance with its terms, except as limited by bankruptcy, insolvency, reorganization, moratorium or similar laws affecting creditors' rights generally.

(v) There is no action, suit, investigation, complaint or other proceeding pending, or to its knowledge, threatened against the Member or to its knowledge any other person that involves any of the transactions contemplated by this Agreement or that, individually or in the aggregate, if determined adversely to such Member or the other person, could materially and adversely affect the ability of the Member to perform its obligations under this Agreement.

(vi) The Member is not in, nor has it received notice of, a violation of or default with respect to any law or regulation applicable to it or its business, properties or operations, which violation or default, individually or in the aggregate, could materially and adversely affect the ability of the Member to perform its obligations under this Agreement.

(vii) The Member is not (i) a "benefit plan investor" within the meaning of Section 2510.3-101(f)(2) of the United States Department of Labor Final Regulation Relating to the Definition of Plan Assets 29 C.F.R. Section 2510.3-101, (ii) a pension, profit sharing or other retirement plan sponsored by the United States or any state, municipality or other political subdivision or any instrumentality of any of the foregoing (or any political subdivision administering such plan), (iii) a benefit plan that would be subject to the ERISA but for the fact that it meets the requirements of a "church plan" within the

meaning of Section 414(e) of the Code and Section 3(33) of ERISA, or (iv) any other entity any of whose assets constitute under applicable law assets of any employee benefit plan subject to Part 4 of Title I of ERISA or of any plan subject to Section 4975 of the Code.

ARTICLE XI

MISCELLANEOUS

11.1 Notices. All notices under this Agreement shall be in writing, duly signed by the party giving such notice, and transmitted by (i) personal delivery (effective upon delivery), (ii) postage prepaid registered or certified mail, return receipt requested, (effective three business days after posting), (iii) facsimile transmission with electronic confirmation of receipt (effective the following business day) or (iv) United States Postal Service Express Mail or a recognized overnight delivery service (effective on the Business Day following dispatch) and addressed in each case as follows:

(i) given to the Company, at its then principal office;

(ii) if given to the Manager, at 90 West Street, Suite 2210, New York, New York 10006, fax no. (212) 732-5086, Attn: James C. Strickler; and

(iii) if given to a Member, at its address set forth on Exhibit A hereto.

Any Member may designate any other address to which notices may be sent by a notice in writing to the Company and the other Members.

11.2 Amendment. This Agreement may not be modified or amended, except with the written consent of all Members, provided that without the consent of any Member, (i) the Manager may amend this Agreement to reflect the admission of substituted Members to which the Members have consented to the extent such consent is required hereunder, and (ii) the Manager, upon 30 days' prior notice to the Members, may amend this Agreement as to administrative or similar matters which do not have any adverse effect on any Member.

11.3 Confidentiality. This Agreement, the terms hereof and the transactions contemplated hereby shall be kept in strict confidence by the parties, except that disclosure may be made (i) to the principals, partners, stockholders, officers, directors, agents and employees of the Members and their respective professional advisors, (ii) to the extent that disclosure may be required by the Asset Management Agreement, the Servicing Agreements or other agreements, instruments or documents to which the Company or the Manager may be subject or may become subject in connection with the management and operation of the business and affairs of the Company or the financing or refinancing of the purchase of the Assets, and (iii) to the extent that disclosure may be required by law or judicial or regulatory order, or to comply with governmental approvals or regulations.

11.4 Captions. Caption designations in this Agreement are inserted only as a guide and for reference and in no way define, limit or describe the scope of this Agreement or the intent of the parties.

11.5 Applicable Law. This Agreement shall be governed by, interpreted and construed in accordance with the laws of the State of Delaware, without regard to conflicts of laws rules.

11.6 Counterparts; Effectiveness. This Agreement may be signed in any number of counterparts, each of which shall be an original, with the same effect as if all signatures were on the same instrument. This Agreement shall become effective upon execution and delivery of a counterpart hereof by each of the parties hereto.

11.7 Entire Agreement. This Agreement constitutes the entire agreement among the parties hereto pertaining to the subject matter hereof and supersedes all prior agreements and understandings pertaining thereto.

11.8 Regulation. The Members and the Manager agree that the Company shall be subject to regulation, supervision and examination by any federal or state bank regulatory authority that has regulatory, supervision or examination authority over any Member.

11.9 Ratification. Each Member hereby ratifies and approves all actions taken by Manager prior to the date of this Agreement in connection with any bid to purchase or otherwise acquire any Pool or other asset, or the purchase or acquisition of any Pool or other asset, whether or not such Member participated in the purchase or acquisition of such Pool or other asset pursuant to Section 4.2 of this Agreement.

[Remainder of page intentionally left blank.]

IN WITNESS WHEREOF, the undersigned have executed and delivered this Agreement as of the day and year first above written.

HANOVER CAPITAL MORTGAGE HOLDINGS, INC., as Manager and as Member

By -----
Name:
Title:

BTD 2001 HDMF-1 CORP., as Member

By -----
Name:
Title:

PROVIDENT FINANCIAL GROUP, INC., as Member

By -----
Name:
Title:

DEFINITION OF CERTAIN TERMS

"Adjusted Capital Account Deficit" shall mean, with respect to any Member, the deficit balance, if any, in such Member's Capital Account as of the end of the applicable Fiscal Year after (i) crediting thereto any amounts which such Member is, or is deemed to be, obligated to restore pursuant to Treasury Regulations Section 1.704-2(g)(1) and Section 1.704-2(i)(5) and (ii) debiting such Capital Account by the amount of the items described in Treasury Regulations Sections 1.704-1(b)(2)(ii)(d)(4), (5) and (6). The foregoing definition of Adjusted Capital Account Deficit is intended to comply with the provisions of Treasury Regulations Section 1.704-1(b)(2)(ii)(d) and shall be interpreted consistently therewith.

"Affiliate" shall have the meaning set forth in Section 2.1 hereof.

"Assets" shall mean primarily sub-performing and non-performing (i) mortgage loans on one-to-four family dwelling and five-to-eight family residential and mixed use properties and (ii) cooperative loans.

"Asset Management Agreement" shall have the meaning set forth in the Recitals.

"Asset Manager" shall have the meaning set forth in the Recitals.

"Bid Summary Sheet" shall have the meaning set forth in Section 4.2(b) hereof.

"Capital Account" shall have the meaning set forth in Section 4.5 hereof.

"Capital Contribution" shall have the meaning set forth in Section 4.2(f) hereof.

"Code" shall mean the U.S. Internal Revenue Code of 1986, as amended from time to time, including the corresponding provisions of any successor law.

"Company" shall mean HDMF-I LLC, a Delaware limited liability company.

"Company Minimum Gain" shall have the meaning attributed to "partnership minimum gain" as set forth in Treasury Regulations Sections 1.704-2(b)(2) and 1.704-2(d).

"Control" shall have the meaning set forth in Section 2.1 hereof.

"Delaware Act" shall have the meaning set forth in Section 1.1 hereof.

"Disposition" shall mean, with respect to a Pool, the sale, exchange or other disposition by the Company of all or any portion of such Pool for cash, securities or other property and shall include the receipt by the Company of (x) the repayment of the principal of and accrued interest on any indebtedness constituting all or a portion of such Pool or of a liquidating or other similar payment in respect of such Pool and (y) the proceeds of any judgment or settlement to the extent made in respect of such Pool (as determined by the Manager in good faith), it being agreed that all judgment and settlement proceeds will be allocated by the Manager (acting in good faith) among the various Assets as applicable.

"Distributable Cash" shall mean, with respect to any Pool, the excess of the aggregate cash receipts of all kinds received by the Company in respect of such Pool, reduced by the sum of (i) all Company expenditures allocable to such Pool (including, without limitation, the payment of principal of and interest on indebtedness of the Company incurred in connection with the acquisition or carrying of such Pool, fees and expenses payable to the Asset Manager and the Servicer relating to such Pool and the payment of other costs, expenses, liabilities and obligations of the Company relating to such Pool) and (ii) such reserves as the Manager deems necessary to make reasonable provision for the discharge of the costs, expenses, liabilities and other obligations of the Company relating to such Pool.

"ERISA" shall have the meaning set forth in Section 8.2(c) hereof.

"Exonerated Person" shall have the meaning set forth in Section 2.3 hereof.

"FDIC" shall mean the Federal Deposit Insurance Corporation.

"Final Disposition" with respect to a Pool means the Disposition of all Assets and other interests in such Pool held by the Company.

"Fiscal Year" shall mean the calendar year.

"Freely Tradable" means securities that are transferable by (i) a Member pursuant to a then effective registration statement under the Securities Act (or similar applicable statutory provision in the case of non-U.S. securities), (ii) the Members who are not Affiliates of the Manager pursuant to Rule 144(k) under the Securities Act (or similar applicable rule in the case of non-U.S. securities), (iii) transferable by the Members pursuant to Rule 144A which shall include a covenant by the issuer of such security to comply with the reporting and informational requirements under Rule 144A or (iv) the Members outside the United States pursuant to Regulation S under the Securities Act (or similar applicable rule in the case of non-U.S. securities).

"Governmental Authorization" shall mean any approval, consent, ratification, waiver, license, permit or other authorization.

"Governmental Body" shall mean any (i) state, county, city, town, village, district or other jurisdiction, (ii) federal, state, local, municipal or other government, or (iii) branch, agency, department, board, commission or other governmental authority.

"Gross Asset Value" shall mean, with respect to any asset, such asset's adjusted basis for federal income tax purposes, except as follows:

(a) the initial Gross Asset Value of any asset contributed by a Member to the Company shall be the gross fair market value of such asset, as agreed to by the contributing Member and the Manager,

(b) the Gross Asset Value of all Company assets shall be adjusted to equal their respective gross fair market values, as of the following times: (i) the acquisition of an additional interest in the Company by any new or existing Member in exchange for

more than a de minimis Capital Contribution; (ii) the distribution by the Company to a Member of more than a de minimis amount of Company assets as consideration for an interest in the Company; and (iii) the liquidation of the Company within the meaning of Regulations Section 1.704-1(b)(2)(ii)(g); provided, however, that adjustments pursuant to clause (i) and clause (ii) of this sentence shall be made only if the Manager reasonably determines that such adjustments are necessary or appropriate to reflect the relative economic interests of the Members in the Company; and

(c) the Gross Asset Value of any Company asset distributed to any Member shall be the gross fair market value of such asset on the date of distribution, as determined by the Manager in good faith.

If the Gross Asset Value of an asset has been determined or adjusted pursuant to paragraph (a) or paragraph (b) above, such Gross Asset Value shall thereafter be adjusted by the depreciation taken into account with respect to such asset for purposes of computing Net Income and Net Loss.

"Income Notes" shall have the meaning set forth in Section 4.2(b) hereof.

"Investment Company Act" shall mean the U.S. Investment Company Act of 1940, as amended.

"Investment Period" shall mean the one-year period commencing on the date of this Amended and Restated Limited Liability Company Agreement and ending on the first anniversary of the date of this Amended and Restated Limited Liability Company Agreement.

"Legal Requirement" shall mean any federal, state, local or municipal law, ordinance, code, regulation, statute or principal of common law.

"Loan Pool Documentation" shall have the meaning set forth in Section 1.3(c)(iv) hereof.

"Manager" shall have the meaning set forth in the Recitals.

"Maximum Capital Contribution" shall mean, with respect to a Member, the maximum amount of Capital Contributions that a Member shall be required to contribute to the Company pursuant to this Agreement, as set forth on Exhibit A attached hereto.

"Member Minimum Gain" shall mean an amount, determined in accordance with Treasury Regulations Section 1.704-2(i)(3) with respect to each Member Nonrecourse Debt, equal to the Company Minimum Gain that would result if such Member Nonrecourse Debt were treated as a Nonrecourse Liability.

"Member Nonrecourse Debt" shall have the meaning attributed to "partner nonrecourse debt" as set forth in Treasury Regulations Section 1.704-2(b)(4).

"Member Nonrecourse Deductions" shall have the meaning attributed to "partner nonrecourse deductions" as set forth in Treasury Regulations Section 1.704-2(i).

"Membership Interest" shall have the meaning set forth in Section 4.1 hereof.

"Net Income" and "Net Loss" shall mean, for each Fiscal Year, an amount equal to the Company's taxable income or loss for such Fiscal Year, determined in accordance with Section 703(a) of the Code (but including in taxable income or loss, for this purpose, all items of income, gain, loss or deduction required to be stated separately pursuant to Section 703(a)(1) of the Code), with the following adjustments:

(a) any income of the Company exempt from federal income tax and not otherwise taken into account in computing Net Income or Net Loss pursuant to this definition shall be added to such taxable income or loss;

(b) any expenditures of the Company described in Section 705(a)(2)(B) of the Code (or treated as expenditures described in Section 705(a)(2)(B) of the Code pursuant to Treasury Regulations Section 1.704-1(b)(2)(iv)(i)) and not otherwise taken into account in computing Net Income or Net Loss pursuant to this definition shall be subtracted from such taxable income or loss;

(c) in the event the fair market value of any Company asset is adjusted in accordance with Section 4.5, the amount of such adjustment shall be taken into account as gain or loss from the disposition of such asset for purposes of computing Net Income or Net Loss;

(d) gain or loss resulting from any disposition of any asset of the Company with respect to which gain or loss is recognized for federal income tax purposes shall be computed by reference to the book value of the asset disposed of under Treasury Regulations Section 1.704-1(b)(2)(iv), notwithstanding that the adjusted tax basis of such asset differs from such book value; and

(e) notwithstanding any other provision of this definition, any items which are allocated under Section 5.3 shall not be taken into account in the computation of "Net Income" or "Net Loss".

"Nonrecourse Deductions" shall have the meaning set forth in Treasury Regulations Section 1.704-2(b)(1).

"Nonrecourse Liability" shall have the meaning set forth in Treasury Regulations Section 1.704-2(b)(3).

"OCC" shall mean the United States Department of Treasury, Office of the Comptroller of the Currency.

"Percentage Interest" shall mean, with respect to each Member, the percentage set forth opposite such Member's name on Exhibit A hereto.

"Pools" shall have the meaning set forth in the Recitals.

"Required Members" shall mean Members holding at least 50.1% of the aggregate Capital Contributions to the Company.

"Securities Act" shall mean the Securities Act of 1933, as amended.

"Servicer" shall mean The Provident Bank and, if applicable, each other entity selected to act as a servicer under a Servicing Agreement from time to time pursuant to the terms of this Agreement.

"Servicing Agreements" shall have the meaning set forth in the Recitals.

"Sharing Percentage" shall have the meaning set forth in Section 4.1.

"Tax Matters Member" shall have the meaning set forth in Section 5.6 hereof.

"Transfer" shall have the meaning set forth in the Recitals.

"Treasury Regulations" or "Regulations" shall mean the applicable provisions of the federal income tax regulations promulgated under the Code, as amended from time to time, including the corresponding provisions of any succeeding regulations.

TABLE OF CONTENTS

	Page

ARTICLE I	
GENERAL.....	2
1.1 Formation of Limited Liability Company.....	2
1.2 Name	2
1.3 Purpose	2
1.4 Term	4
1.5 Place of Business.....	4
1.6 Registered Office and Registered Agent.....	4
1.7 Qualification.....	4
ARTICLE II	
DUTIES, POWERS AND LIABILITY OF MANAGER AND MEMBERS; CONFLICTS OF INTEREST; INDEMNIFICATION.....	4
2.1 Powers of Manager.....	4
2.2 Powers of Members.....	7
2.3 Appointment of Officers.....	7
2.4 Limitation on Manager's Liability.....	7
2.5 Limitation on Member's Liability.....	7
2.6 Compensation of Manager.....	7
2.7 Conflicts of Interest.....	8
2.8 Indemnification of Manager.....	8
2.9 Limits on Manager's Powers.....	9
ARTICLE III	
ASSET MANAGEMENT AND SERVICING.....	9
3.1 Asset Management Agreement.....	9
3.2 Servicing Agreements.....	10
ARTICLE IV	
CAPITAL CONTRIBUTIONS; INCOME NOTES; CAPITAL ACCOUNTS	10
4.1 Membership Interests.....	10
4.2 Capital Contributions.....	10

4.3	Interest on Capital.....	12
4.4	Return of Capital Contribution.....	12
4.5	Capital Accounts.....	12

ARTICLE V

ALLOCATIONS; DISTRIBUTIONS..... 13

5.1	Allocations of Net Income and Losses.....	13
5.2	Limitation on Loss Allocation.....	13
5.3	Special Allocations.....	14
5.4	Tax Incidents.....	16
5.5	Section 704(c) Allocations.....	16
5.6	Tax Matters Member; Tax Elections.....	16
5.7	Distributions of Distributable Cash.....	16
5.8	Distributions In-Kind.....	17

ARTICLE VI

FINANCIAL MANAGEMENT..... 18

6.1	Costs, Expenses, Liabilities and Obligations.....	18
6.2	Books and Records.....	18
6.3	Fiscal Year.....	18
6.4	Reports.....	18
6.5	Bank Accounts and Investment of Funds.....	19
6.6	Accounting Decisions.....	19
6.7	Income Tax Returns and Elections.....	19

ARTICLE VII

TRANSFERS BY MEMBERS; SUBSTITUTE MEMBERS..... 19

7.1	Transfers by Members.....	19
7.2	Substitute Members.....	20

ARTICLE VIII

DISSOLUTION, LIQUIDATION AND TERMINATION..... 20

8.1	Limitations.....	20
8.2	Exclusive Causes.....	20
8.3	Liquidation.....	21
8.4	Continuation of the Company.....	22

	Page

ARTICLE IX	
ATTORNEY-IN-FACT.....	22
ARTICLE X	
REPRESENTATIONS AND WARRANTIES.....	23
10.1 Securities Law Representations.....	23
10.2 Other Representations and Warranties.....	24
ARTICLE XI	
MISCELLANEOUS.....	25
11.1 Notices	25
11.2 Amendment.....	25
11.3 Confidentiality.....	26
11.4 Captions.....	26
11.5 Applicable Law.....	26
11.6 Counterparts; Effectiveness.....	26
11.7 Entire Agreement.....	26
11.8 Regulation.....	26

SCHEDULES

Schedule I Definition of Certain Terms

EXHIBITS

Exhibit A Members and Commitments

Exhibit B Asset Management Agreement

Exhibit C Form of Income Note

(i)

EXHIBIT 21

.
.

.

Consolidated Subsidiaries of Hanover Capital Mortgage Holdings, Inc.

Subsidiary -----	Jurisdiction -----	d/b/a -----
Hanover Capital Partners Ltd.	New York	None
Hanover Capital Mortgage Corporation (1)	Missouri	California d/b/a Missouri Hanover Capital Mortgage Corporation
Hanover Capital Securities, Inc. (1)	New York	None
Hanover Capital Partners 2, Inc.	Delaware	None
Hanover SPC-2, Inc. (2)	Delaware	None
HanoverTrade, Inc.	Delaware	None
Pamex Securities, LLC (3)	New Jersey	None
Hanover Capital SPC, Inc.	Delaware	None
Hanover Capital Repo Corp.	Delaware	None
Hanover QRS-1 98-B, Inc.	Delaware	None
Hanover QRS-2 98-B, Inc.	Delaware	None
Hanover SPC-A, Inc.	Delaware	None

Unconsolidated Subsidiaries of Hanover Capital Mortgage Holdings, Inc.

Subsidiary -----	Jurisdiction -----	d/b/a -----
HDMF-I LLC	Delaware	None
HDMF-II LLC (4)	Delaware	None
HDMF-II Realty Corp. (5)	Delaware	None

- (1) Subsidiary of Hanover Capital Partners Ltd.
- (2) Subsidiary of Hanover Capital Partners 2, Inc.
- (3) Subsidiary of HanoverTrade, Inc.
- (4) Subsidiary of HDMF-I LLC
- (5) Subsidiary of HDMF-II LLC

EXHIBIT 23.1

INDEPENDENT AUDITORS' CONSENT

We consent to the incorporation by reference in Registration Statements Nos. 333-84290 and 333-99483 of Hanover Capital Mortgage Holdings, Inc. on Form S-8 of our reports dated March 20, 2003, appearing and incorporated by reference in this Annual Report on Form 10-K of Hanover Capital Mortgage Holdings, Inc. and Subsidiaries for the fiscal year ended December 31, 2002.

/s/ DELOITTE & TOUCHE LLP
Parsippany, New Jersey
March 28, 2003

EXHIBIT 99.1

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED
PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, John A. Burchett, President and Chief Executive Officer (principal executive officer) of Hanover Capital Mortgage Holdings, Inc. (the "Registrant"), certify that, to the best of my knowledge, based on a review of the Annual Report on Form 10-K for the year ended December 31, 2002 of the Registrant (the "Report"):

- (1) The Report fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

HANOVER CAPITAL MORTGAGE HOLDINGS, INC.

By: /s/ John A. Burchett

John A. Burchett
President and Chief Executive Officer

Dated: March 28, 2003

EXHIBIT 99.2

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED
PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, J. Holly Loux, Chief Financial Officer (principal financial officer) of Hanover Capital Mortgage Holdings, Inc. (the "Registrant"), certify that, to the best of my knowledge, based on a review of the Annual Report on Form 10-K for the year ended December 31, 2002 of the Registrant (the "Report"):

- (1) The Report fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

HANOVER CAPITAL MORTGAGE HOLDINGS, INC.

By: /s/ J. Holly Loux

J. Holly Loux
Chief Financial Officer

Dated: March 28, 2003