LUMINENT MORTGAGE CAPITAL INC
Form 424B4
December 19, 2003
Table of Contents

Filed Pursuant to Rule 424(b)(4)

Registration Nos. 333-107984 and 333-111372

PROSPECTUS

11,400,000 Shares

Common Stock

This is the initial public offering of our common stock. No public market currently exists for our common stock. We are offering 11,400,000 shares of our common stock. Our common stock is subject to transfer restrictions intended to preserve our status as a real estate investment trust.

Our common stock is not currently listed on any national exchange or market system. However, following our private placement in June 2003, our common stock has been sold from time to time in private transactions and some of those sales have been reported on The Portal Market. Our common stock has been approved for listing on the New York Stock Exchange, subject to official notice of issuance, under the symbol LUM.

We have filed a separate registration statement covering resale by our existing stockholders of up to 11,500,000 shares of our common stock that are not included in this underwritten public offering.

Investing in our common stock involves risks. See Risk Factors beginning on page 13 for a discussion of risks relating to our common stock, including, among others:

- We commenced operations in June 2003 and have a limited operating history. Our manager, Seneca Capital Management LLC, or Seneca, has no prior experience managing a REIT. Accordingly, we might not be able to operate our business or implement our operating policies and strategies successfully.

- We have not identified any specific mortgage-backed securities to acquire with the net proceeds of this offering. Accordingly, you will not have the opportunity to review the assets we will acquire with the net proceeds of this offering prior to your investment. In addition, we may not be able to acquire such assets on a timely basis or upon favorable terms.

- Our investment strategy permits us to invest up to 10% of our assets in unrated mortgage-related assets, including mortgage-backed securities rated below investment grade. These assets carry an increased likelihood of default or rating downgrade relative to investment-grade assets, which may cause us to suffer losses.

Interest rate mismatches between our mortgage-backed securities and our borrowings used to fund our purchases of mortgage-backed securities might reduce our net income or result in a loss during periods of changing interest rates.

Increased levels of prepayments on the mortgages underlying our mortgage-backed securities might decrease our net interest income or result in a net loss.

We generally seek to borrow eight to 12 times the amount of our equity. Such leveraging could reduce our net income and our cash available for distributions or cause us to suffer losses.

Our board of directors may change our operating policies and strategies without prior notice to you or stockholder approval and such changes could harm our business and results of operations and the value of our stock.

Our results may suffer as a consequence of a potential conflict of interest arising out of our relationship with Seneca, on the one hand, and Seneca s relationship with other third parties, on the other hand. In addition, this potential conflict may reduce the amount of time and effort that Seneca devotes to managing our business and may result in suitable investment opportunities being allocated to other entities.

We pay Seneca incentive compensation based on our portfolio s performance. Accordingly, Seneca may recommend riskier or more speculative investments in an effort to maximize its incentive compensation.

	Per Share	Total
Public offering price	$ 13.00	$ 148,200,000
Underwriting discounts and commissions	$ 0.91	$ 10,374,000
Proceeds, before expenses, to us	$ 12.09	$ 137,826,000

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

We have granted the underwriters a 30-day option to purchase up to an additional 1,710,000 shares of our common stock to cover over-allotments, if any. We expect the shares of our common stock will be ready for delivery to purchasers on or about December 24, 2003.

FRIEDMAN BILLINGS RAMSEY

CREDIT SUISSE FIRST BOSTON

JMP SECURITIES

FLAGSTONE SECURITIES

The date of this prospectus is December 18, 2003

Table of Contents

You should rely only on the information contained in this document. We have not authorized anyone to provide you with information that is different. This document may be used only where it is legal to sell these securities. The information in this document may be accurate only on the date of this document.

TABLE OF CONTENTS

We have filed for registration in the U.S. Patent and Trademark Office for the marks Luminent Mortgage Capital, Inc. and Luminent. All other brand names or trademarks appearing in this prospectus are the property of their respective holders.

Table of Contents

SUMMARY

This summary highlights the material information contained elsewhere in this prospectus. You should read this entire prospectus carefully, including the section titled Risk Factors and our financial statements and the notes thereto before making an investment in our common stock. As used in this prospectus, Luminent, company, we, our, and us refer to Luminent Mortgage Capital, Inc., except where the context otherwise requires. Unless otherwise indicated, the information in this prospectus assumes that the underwriters will not exercise their over-allotment option to purchase additional shares of our common stock.

Luminent Mortgage Capital, Inc.

We were formed in April 2003 to invest primarily in U.S. agency and other highly-rated, single-family, adjustable-rate, hybrid adjustable-rate and fixed-rate mortgage-backed securities, which we acquire in the secondary market. Our strategy is to acquire mortgage-related assets, finance these purchases in the capital markets and use leverage in order to provide an attractive return on stockholders equity. Through this strategy, we seek to earn income, which is generated from the spread between the yield on our earning assets and our costs, including the interest cost of the funds we borrow.

We commenced operations in June 2003, following the completion of a private placement of our common stock, in which we raised net proceeds of approximately $159.7 million. As of September 30, 2003, we had invested substantially all of the net proceeds from that offering, plus approximately $1.5 billion of borrowed funds, in a total of $1.6 billion of U.S. agency and other highly-rated, residential mortgage-backed securities. We invest primarily in adjustable-rate and hybrid adjustable-rate mortgage-backed securities. Adjustable-rate mortgage-backed securities have interest rates that reset periodically, typically every six months or on an annual basis. Hybrid adjustable-rate mortgage-backed securities have interest rates that are fixed for the first few years of the loan typically three, five, seven or 10 years and thereafter reset periodically in a manner similar to adjustable-rate mortgage-backed securities. As of September 30, 2003, approximately 12.3% of our investment portfolio was comprised of adjustable-rate mortgage-backed securities and approximately 84.3% was comprised of hybrid adjustable-rate mortgage-backed securities. In addition, as of September 30, 2003, 67% of the mortgage-backed securities in our investment portfolio were guaranteed by Fannie Mae, Freddie Mac or the Government National Mortgage Administration, or Ginnie Mae, and the remaining 33% had AAA credit ratings from at least one nationally-recognized statistical rating agency.

We have acquired and will seek to acquire additional assets that will produce competitive returns, taking into consideration the amount and nature of the anticipated returns from the investment, our ability to pledge the investment for secured, collateralized borrowings and the costs associated with financing, managing, securitizing and reserving for these investments. As of the date of this prospectus, we have not identified any specific mortgage-backed securities that we intend to acquire with the net proceeds of this offering. We expect that all of the mortgage-backed securities that we acquire will be agency-backed or have AAA credit ratings from at least one nationally-recognized statistical rating agency, and most of the securities will be hybrid adjustable-rate mortgage-backed securities. As of June 30, 2003, the market for residential mortgage debt that had been securitized into mortgage-backed securities was approximately $4.0 trillion, approximately $3.2 trillion of which was agency-backed and, therefore, generally consistent with our investment guidelines. As of June 30, 2003, approximately $45.0 billion of the available mortgage-backed securities was held by REITs.

We have financed our acquisition of mortgage-related assets by investing our equity and by borrowing at short-term rates under repurchase agreements. We intend to continue to finance our acquisitions in this manner.

Table of Contents

We generally seek to borrow between eight and 12 times the amount of our equity. We actively manage the adjustment periods and the selection of the interest rate indices of our borrowings against the adjustment periods and the selection of indices on our mortgage-related assets in order to manage our liquidity and interest rate related risks. We may also choose to engage in various hedging activities designed to match more closely the terms of our assets and liabilities. As of September 30, 2003, we were not a counterparty to any hedging arrangements. Subsequent to September 30, 2003 we entered into hedging arrangements as described in Recent Developments, below.

As a long-term holder of mortgage-backed securities we are focused on acquiring, financing and managing a diverse portfolio of mortgage-backed securities with a variety of characteristics that we believe will provide attractive returns in a multitude of interest rate and prepayment environments. We do not construct our overall investment portfolio in order to express a directional expectation for interest rates or mortgage prepayment rates.

We review the credit risk associated with each potential investment and may diversify our portfolio to avoid undue geographic, insurer, industry and other types of concentrations. By maintaining a large percentage of our assets in high quality and highly-rated assets, many of which are guaranteed under limited circumstances as to payment of a limited amount of principal and interest by federal agencies or federally chartered entities such as Fannie Mae, Freddie Mac or Ginnie Mae, we believe we can mitigate our exposure to losses from credit risk.

In addition to the strategies described above, we intend to use other strategies to seek to generate earnings and distributions to our stockholders, which may include the following:

- increasing the size of our balance sheet at a rate faster than the rate of increase in our operating expenses;
- using leverage to increase the size of our balance sheet; and
- lowering our effective borrowing costs over time by seeking direct funding with collateralized lenders.

We are externally managed and advised by Seneca Capital Management LLC, or Seneca, pursuant to a management agreement with Seneca. We have a full-time chief financial officer, who is not employed by Seneca, to provide us with dedicated financial management, analysis and investor relations capability.

We expect to qualify and will elect to be taxed as a real estate investment trust, or REIT, under the Internal Revenue Code of 1986, as amended, and as such will routinely distribute substantially all of the income generated from our operations to our stockholders. As long as we retain our REIT status, we generally will not be subject to U.S. federal or state taxes on our income to the extent that we distribute our net income to our stockholders.

Our principal offices are located at 909 Montgomery Street, Suite 500, San Francisco, California 94133. Our telephone number is (415) 486-2110.

Recent Developments

Following the completion of our private placement in June and the purchase of substantially all of our mortgage-backed securities with the net proceeds of our private placement, the U.S. bond markets experienced dramatic price and yield volatility. For example, between June 1, 2003 and September 30, 2003, the 10-year U.S. Treasury yield ranged from a low of 3.11% on June 13, 2003 to a high of 4.60% on September 2, 2003, an increase of approximately 48%. This increase in interest rates caused the overall market value of our portfolio to decrease, and our leverage (defined as our total debt divided by stockholders equity) to increase beyond our desired range. By August 13, 2003, the 10-year U.S. Treasury yield had increased to 4.56% and, as a result, the unrealized loss on the securities in our portfolio had increased to $37.8 million and our leverage correspondingly increased to 13.6 times our stockholders equity.

Table of Contents

In response to these conditions, we implemented a strategy of reducing portfolio leverage by selling approximately $130.7 million of our mortgage-backed securities on August 13, 2003. On August 14, 2003, we also sold short approximately $200.0 million of Fannie Mae 15-year 4.50% coupon mortgage-backed securities for settlement on September 18, 2003 in an effort to seek to protect the value of our portfolio against possible additional increases in interest rates. This short position was fully covered between September 11, 2003 and September 15, 2003. These strategies successfully reduced our leverage and overall risk exposure to further increases in interest rates. Although these activities resulted in losses, other means of generating cash to reduce leverage were not practically available to us at that time. For example, because we had purchased our portfolio so recently, cash flow from interest income and prepayments was insufficient to enable us to reduce leverage through the ordinary course of portfolio management. Similarly, because our registration statements were pending with the Securities and Exchange Commission, or the SEC, additional capital could not be readily raised during this time period to effect a reduction in leverage. Given the greater seasoning of our portfolio today, the cash flow characteristics of our investments, and an opportunity to raise additional equity as a public company upon completion of this offering, among a number of other considerations, we now have a greater combination of risk mitigation factors that enable us to protect our balance sheet in the future.

During the quarter ended September 30, 2003, we earned net interest income of approximately $6.5 million. However, we realized net capital losses of $7.8 million that resulted in a reported net loss for the quarter of $2.8 million, or $0.24 per fully diluted share. These results are calculated in accordance with accounting principles generally accepted in the United States, which are known as GAAP. When the net capital losses and other compensation and organizational expenses are added back for purposes of calculating the REIT taxable net income for the quarter ended September 30, 2003, REIT taxable net income was approximately $5.7 million or $0.48 per share. REIT taxable net income is calculated according to the requirements of the Internal Revenue Code, rather than GAAP. A reconciliation of our REIT taxable net income to our GAAP-basis net loss as of September 30, 2003 appears on page 67 of this prospectus.

On October 1, 2003, we declared and, on November 17, 2003, we paid a cash distribution of $0.50 per share, which represented 98% of our REIT taxable net income since inception. The cash distribution was funded entirely with cash flow from our ongoing operations, including principal payments and interest payments on our mortgage-backed securities. At the end of the quarter, our manager voluntarily waived on a one-time basis its right to receive incentive fees of $613,247 which it otherwise earned during the quarter ended September 30, 2003. The waived incentive fee has been accounted for as a capital contribution as of September 30, 2003. The incentive fee is calculated primarily based upon REIT taxable net income and was expensed in the quarter ended September 30, 2003.

For the month ended September 30, 2003, the yield on average earning assets, net of amortization of premium was 2.61% and the cost of funds on the average repurchase balance as of September 30, 2003 was 1.20%, resulting in an interest rate spread of 1.41%.

Through September 30, 2003, our borrowings have been exclusively in the form of repurchase agreements from a broadly diversified group of repurchase lenders. As of September 30, 2003, the outstanding balance under our repurchase agreements was approximately $1.5 billion, equating to leverage of approximately 10.6, with a weighted average interest rate of 1.20% and a weighted average maturity of 254 days.

As of September 30, 2003, approximately 67% of our assets were invested in agency mortgage-backed securities and the remaining 33% were invested in AAA rated mortgage-backed securities. These mortgage-backed securities were valued at approximately $1.6 billion and were allocated as follows:

- 12.3% in adjustable-rate mortgage-backed securities;
- 84.3% in hybrid adjustable-rate mortgage-backed securities, with the majority of our holdings in 3/1 hybrids;

3

3.4% in one balloon mortgage-backed security which matures in January 2008; and

0.0% in fixed rate mortgage-backed securities.

The constant prepayment rate, or CPR, on our mortgage-backed securities for the month ended September 30, 2003 was 28%. CPR attempts to predict the percentage of principal that will prepay over the next 12 months based on historical principal paydowns. As interest rates have risen, the rate of refinancings has declined sharply, which we believe will result in lower rates of prepayments and, as a result, a lower portfolio CPR.

As of September 30, 2003, the weighted average effective duration of the securities in our overall investment portfolio, assuming constant prepayment rates to the balloon or reset date, or the CPB duration, was 1.7 years. CPB is similar to CPR except that it also assumes that the hybrid adjustable-rate mortgage-backed securities prepay in full at their next reset date. As of September 30, 2003, the mortgages underlying our hybrid adjustable-rate mortgage-backed securities had fixed interest rates for a weighted average of 49 months, after which time the interest rates reset and become adjustable. The average length of time until maturity of those mortgages was 30 years. Those mortgages are also subject to interest rate caps that limit the amount that the applicable interest rate can increase during any year, known as an annual cap, and through the maturity of the applicable security, known as a lifetime cap. As of September 30, 2003, the mortgages underlying our hybrid adjustable-rate mortgage-backed securities had average annual caps of 2.44% and average lifetime caps of 9.99%.

Average stockholders equity for the quarter ended September 30, 2003 was $147.3 million. Due to the losses on sales of securities described above, return on average equity was (1.89%) for the quarter ended September 30, 2003.

Our book value at September 30, 2003 was $139.5 million, or $11.91 per share, based on 11,704,000 shares outstanding on that date. As of September 30, 2003, the accumulated other comprehensive loss related to the fair market value adjustment for our mortgage-backed securities was $18.2 million, which represents a $13.6 million increase during the quarter.

In the month ended October 31, 2003, we earned net interest income of $2.2 million, and net income of $1.9 million, or $0.16 per fully diluted share. For the month ended October 31, 2003, the yield on average earning assets, net of amortization of premium, was 2.84%, and the cost of funds on our average repurchase agreement liabilities at October 31, 2003 was 1.20%, resulting in an average interest rate spread of 1.64%. The constant prepayment rate, or CPR, on our mortgage-backed securities for the month ended October 31, 2003, was 25%.

Our book value at November 26, 2003 was $126.8 million, or $10.84 per share, based on 11,704,000 shares outstanding on that date. As of November 26, 2003, the accumulated other comprehensive loss related to the fair market value adjustment for our mortgage-backed securities was $21.7 million.

On November 24, 2003 our board of directors declared a cash distribution of $0.45 per share for the fourth quarter of 2003, payable on January 28, 2004 to stockholders of record on December 11, 2003. This public offering will close after the distribution record date and, accordingly, purchasers of common stock in this offering will not receive this distribution. Although we reported a net loss of $2.8 million for the three months ended September 30, 2003, and our results of operations for the three months ending December 31, 2003 cannot be definitively predicted at this time, we expect that this cash distribution will be funded with cash flow from our ongoing operations and not with any portion of the proceeds of this offering. The aggregate amount of our fourth quarter distribution payable on January 28, 2004 is $5.3 million, and our current portfolio generates a monthly cash flow significantly in excess of this distribution payable amount. For example, for the three months ended October 31, 2003, we received from our portfolio combined coupon cash flow and principal payments in the amount of $141.9 million, for an average of $47.3 million per month.

4

Table of Contents

Subsequent to September 30, 2003, we engaged in short sales of Euro dollar futures contracts in order to hedge the impact of changes in interest rates on our liability costs. We sold short 1,725 Euro dollar futures contracts, which expire in March 2004, June 2004 and September 2004, with a notional amount totaling $1,725.0 million. The value of these futures contracts is marked to market daily in our margin account with the custodian. Based upon the daily market value of these futures contracts, we either receive funds into, or wire funds into, our margin account with the custodian to ensure that an appropriate margin account balance is maintained at all times through the expiration of the contracts.

These contracts have been designated as cash flow hedges of our borrowings under repurchase agreements under Statement of Financial Accounting Standards, or SFAS, No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended and interpreted, and therefore we have applied hedge accounting to these transactions. The futures contracts are valued at fair value with the resulting gain or loss associated with the effective portion of the hedge recognized in accumulated other comprehensive income until the quarter following contract expiration. The gain or loss associated with the ineffective portion will be recognized in earnings in the current quarter when the effectiveness measurement is made.

Under SFAS No. 133 and our hedging policy, at the inception and during the life of a hedging relationship, the hedge must be expected to be highly effective in offsetting changes in the hedged item s fair value or the variability in cash flows attributable to the hedged risk. In applying our policy, we have determined that these contracts are highly effective as follows. We use regression methodology to assess the effectiveness of our hedging strategies. Specifically, at the inception of each new hedge, we assess effectiveness using ordinary least squares regression to evaluate the correlation between the rates consistent with the hedges and the underlying hedged items. A hedge is highly effective if the changes in the fair value of the derivative provide offset of at least 80% and not more than 120% of the changes in fair value or cash flows of the hedged item attributable to the risk being hedged.

Risk Factors

An investment in our common stock involves material risks, including a number of potential conflicts of interests between us, on the one hand, and Seneca and its affiliates, on the other hand. Each prospective purchaser of our common stock should consider carefully the matters discussed under Risk Factors beginning on page 13 before investing in our common stock. Some of the risks include:

- We commenced operations in June 2003 and have a limited operating history. Our manager, Seneca, has no prior experience managing a REIT. Accordingly, we might not be able to operate our business or implement our operating policies and strategies successfully.

- We have not identified any specific mortgage-backed securities to acquire with the net proceeds of this offering. Accordingly, you will not have the opportunity to review the assets we will acquire with the net proceeds of this offering prior to your investment. In addition, we may not be able to acquire such assets on a timely basis or upon favorable terms.

- Our investment strategy permits us to invest up to 10% of our assets in unrated mortgage-related assets, including mortgage-backed securities rated below investment grade. These assets carry an increased likelihood of default or rating downgrade relative to investment-grade assets, which may cause us to suffer losses.

- Interest rate mismatches between our mortgage-backed securities and our borrowings used to fund our purchases of mortgage-backed securities might reduce our net income or result in a loss during periods of changing interest rates.

Increased levels of prepayments on the mortgages underlying our mortgage-backed securities might decrease our net interest income or result in a net loss.

We generally seek to borrow eight to 12 times the amount of our equity. Such leveraging could reduce our net income and our cash available for distributions or cause us to suffer losses.

Our board of directors may change our operating policies and strategies without prior notice to you or stockholder approval and such changes could harm our business and results of operations and the value of our stock.

Our results may suffer as a consequence of a potential conflict of interest arising out of our relationship with our manager, on the one hand, and our manager s relationship with other third parties, on the other hand. In addition, this potential conflict may reduce the amount of time and effort that our manager devotes to managing our business and may result in suitable investment opportunities being allocated to other entities.

We pay our manager incentive compensation based on our portfolio s performance. Accordingly, our manager may recommend riskier or more speculative investments in an effort to maximize its incentive compensation.

Our Manager and Executive Officers

Our day-to-day operations are externally managed and advised by our manager, Seneca Capital Management LLC, or Seneca, subject to the direction and oversight of our board of directors. Established in 1989, Seneca is a registered investment adviser under the Investment Advisers Act of 1940, as amended. Seneca engages in investment management as its sole business and manages fixed-income and equity assets for pension and profit-sharing plans, financial institutions, such as banking and insurance companies, and mutual funds for retail and institutional investors. Seneca had over 100 full-time employees and approximately $13 billion of institutional and private investment accounts at September 30, 2003.

From time to time, we will assess whether we should be internally managed. Our assessment will be based on a number of factors deemed relevant by our board of directors, including our ability to attract and retain full-time employees and the costs and expenses related to becoming internally managed.

A majority of the outstanding equity interests of Seneca are owned by Phoenix Investment Partners, Ltd. Phoenix Investment is a wholly-owned subsidiary of The Phoenix Companies, Inc. (NYSE: PNX). Our board of directors consists of seven members, five of whom are not affiliated with Seneca or Phoenix. Neither this prospectus nor this offering are endorsed or guaranteed in any way by Seneca or Phoenix.

Our executive officers have significant experience in providing investment advisory services, with an average of 16 years of experience. Prior to founding Seneca, Gail Seneca, our chief executive officer, spent two years as senior vice president of the Asset Management Division of Wells Fargo Bank, where she managed fixed-income assets in excess of $10 billion. Before joining Seneca as its fixed income chief investment officer, Albert Gutierrez, our president, spent two years as head of portfolio management, trading and investment systems at American General Investment Management where he was responsible for approximately $75 billion in client assets, and 12 years with Conseco Capital Management as a senior vice president in charge of fixed income research and trading as well as insurance asset portfolio management. Other than our full-time chief financial officer, all of our executive officers are also managers or employees of Seneca, as described in the following table:

Name	Position with Seneca	Position with Us
Gail P. Seneca, Ph.D.	President/Chief Executive Officer and Chief Investment Officer	Chairman of the Board of Directors and Chief Executive Officer
Albert J. Gutierrez, CFA	Fixed Income Chief Investment Officer and Principal	President and Director

Christopher J. Zyda	None	Senior Vice President and Chief Financial Officer
Andrew S. Chow, CFA	Fixed Income Portfolio Manager	Senior Vice President
Troy A. Grande, CFA	Fixed Income Portfolio Manager	Senior Vice President

Table of Contents

The Management Agreement

We have entered into a management agreement with Seneca dated June 11, 2003. Pursuant to the management agreement, Seneca, as our sole manager, generally implements our business strategy, is responsible for our day-to-day operations and performs services and activities relating to our assets and operations in accordance with the terms of the management agreement. Seneca s services for us can be divided into the following three primary activities:

Asset Management Seneca advises us with respect to, arranges for and manages the acquisition, financing, management and disposition of, our investments.

Liability Management Seneca evaluates the credit risk and prepayment risk of our investments and arranges borrowing and hedging strategies.

Capital Management Seneca coordinates our capital raising activities.

In conducting these activities, Seneca advises us on the formulation of, and implements, our operating strategies and policies, arranges for our acquisition of assets, monitors the performance of our assets, arranges for various types of financing and hedging strategies, and provides administrative and managerial services in connection with our operations. At all times in the performance of these activities, Seneca is subject to the direction and oversight of our board of directors.

Pursuant to the management agreement and a cost-sharing agreement between Seneca and us, Seneca may earn or be entitled to receive the following compensation, fees and other benefits:

Base management fee 1% per annum of the first $300 million of our average net worth, plus 0.8% per annum of our average net worth in excess of $300 million during such fiscal year, calculated on a quarterly basis;

Incentive compensation a specified percentage of our REIT taxable net income (before deducting incentive compensation, net operating losses and certain other items) in excess of a threshold amount of taxable income, calculated on a quarterly basis and subject to annual reconciliation;

Out-of-pocket expense reimbursements reimbursement of actual out-of-pocket expenses incurred in connection with our administration on an on-going basis;

Reimbursement of overhead expenses reimbursement of actual costs attributable to our use of services rendered by Seneca pursuant to the cost-sharing agreement. Our portion of such costs is allocated to us as determined by Seneca, subject to reasonable approval by a majority of our independent directors; and

Termination fee payable only upon termination by us without cause or by Seneca upon our change of control. Actual amount of fee depends on the circumstances of the termination.

For a more detailed discussion of the compensation and other fees payable to Seneca, see The Manager The Management Agreement and The Manager The Cost-Sharing Agreement.

Conflicts of Interest

We are subject to potential conflicts of interest involving Seneca and its affiliates because, among other reasons:

- the incentive compensation, which is based on our net income, may create an incentive for Seneca to recommend investments with greater income potential, which may be relatively more risky than would be the case if its compensation from us did not include an incentive-based component;

Table of Contents

Seneca and its affiliates are permitted to purchase mortgage-backed securities for their own account and to advise accounts of other clients, and certain investment opportunities appropriate for us also will be appropriate for these accounts; and

two of our directors, and all but one of our executive officers, are managers or employees of, or otherwise affiliated with, Seneca.

For a more detailed discussion of potential conflicts of interests between us, on the one hand, and Seneca and its affiliates, on the other hand, see Conflicts of Interests; Certain Relationships and Related Transactions.

The management agreement does not limit or restrict the right of Seneca or any of its affiliates from engaging in any business or rendering services to any other person, including, without limitation, the purchase of, or rendering advice to others purchasing, mortgage-backed securities that meet our investment guidelines. However, Seneca has agreed that for as long as Seneca is our exclusive manager pursuant to the management agreement, it will not sponsor any other mortgage REIT that invests primarily in high-quality, residential mortgage-backed securities, without first obtaining the approval of a majority of our independent directors.

Table of Contents

This Offering

Common stock offered by us	11,400,000 shares(1)
Common stock offered by selling stockholders	0 shares(2)
Common stock to be outstanding after this offering	23,104,000 shares(3)
Use of proceeds	We intend to invest 100% of the net proceeds of this offering (after offering expenses and underwriting discounts and commissions) to expand our portfolio of mortgage-related assets, primarily U.S. agency and other highly-rated, single-family, adjustable-rate, hybrid adjustable-rate and fixed-rate mortgage-backed securities. Until such assets can be identified and obtained, we intend to temporarily invest the balance of the net proceeds of this offering in readily marketable interest-bearing assets consistent with our intention to qualify as a REIT. We estimate that the expenses of this offering and our resale registration will be approximately $850,000. See Use of Proceeds.
Trading	This is our initial public offering. No public market currently exists for shares of our common stock. Our common stock is not listed on any national securities exchange or on Nasdaq. Our common stock has been approved for listing on the New York Stock Exchange, subject to official notice of issuance, under the symbol LUM, however, an active trading market for our shares might never develop.

(1) Excludes up to 1,710,000 shares of our common stock that may be issued by us upon exercise of the underwriters over-allotment option.

(2) A preliminary version of this prospectus included 2,353,331 shares offered for the account of various selling stockholders and disclosed that those selling stockholders had the right to withdraw their shares from this offering at any time until the 10th day prior to the effective date of the registration statement of which this prospectus is a part. All of those selling stockholders subsequently exercised their rights to withdraw those shares from this offering.

(3) Based on 11,704,000 shares outstanding on September 30, 2003, and excludes (a) up to 1,710,000 shares of our common stock that may be issued by us upon exercise of the underwriters over-allotment option, (b) 50,000 shares of our common stock issuable upon the exercise of options outstanding on September 30, 2003, and (c) an aggregate of 950,000 additional shares of our common stock available for issuance under our 2003 stock incentive plan and 2003 outside advisors stock incentive plan.

Subsequent to September 30, 2003 we issued options to purchase 5,000 shares of our common stock at an exercise price of $13.00 per share.

Table of Contents

Our directors and officers are expected to purchase an aggregate of 93,700 shares in this offering from the underwriters at the public offering price shown on the cover of this prospectus as follows:

Name	Shares to be Purchased in this Offering	Shares Beneficially Owned following this Offering
Gail P. Seneca, Ph.D.		107,527
Albert J. Gutierrez, CFA	10,000	112,000
Bruce A. Miller, CPA		1,000
John McMahan	3,700	4,200
Robert B. Goldstein	20,000	37,921
Donald H. Putnam	15,000	15,000
Joseph E. Whitters, CPA	32,500	50,000
Christopher J. Zyda	3,500	3,500
Andrew S. Chow, CFA	4,500	30,000
Troy A. Grande, CFA	4,500	30,000
All directors and officers as a group	93,700	391,148

Our Tax Status

We intend to qualify and will elect to be taxed as a REIT under the Internal Revenue Code commencing with our taxable year ending December 31, 2003. Provided we qualify as a REIT, we generally will not be subject to U.S. federal corporate income tax on taxable income that we distribute to our stockholders. REITs are subject to a number of organizational and operational requirements, including a requirement that they currently distribute at least 90% of their annual REIT taxable net income. We face the risk that we might not be able to comply with all of the REIT requirements in the future. Failure to qualify as a REIT would render us subject to U.S. federal income tax (including any applicable alternative minimum tax) on our taxable income at regular corporate rates, and distributions to our stockholders would not be deductible. Even if we qualify for taxation as a REIT, we may be subject to certain U.S. federal, state, local and foreign taxes on our income and property. See United States Federal Income Tax Considerations.

Restrictions on Ownership of Our Stock

In order to facilitate our qualification as a REIT, our charter prohibits any stockholder from directly or indirectly owning more than 9.8% of the outstanding shares of any class or series of our stock. We adopted this restriction to promote compliance with the provisions of the Internal Revenue Code which limit the degree to which ownership of a REIT may be concentrated. See Description of Capital Stock Transfer Restrictions.

Distributions

To avoid corporate income and excise tax and to maintain our qualification as a REIT, we intend to make quarterly distributions to our stockholders that will result in annual distributions of at least 90% of our REIT taxable net income, determined without regard to the deduction for dividends paid and by excluding any net capital gains. REIT taxable net income is calculated pursuant to standards in the Internal Revenue Code and will not necessarily be the same as our net income as calculated in accordance with generally accepted accounting principles, or GAAP. Our board of directors may, in its discretion, cause us to make additional distributions of cash legally available for that purpose. Our distributions from quarter to quarter will depend on our taxable earnings, financial condition and such other factors as our board of directors deems relevant. In the future, our board of directors may elect to adopt a dividend reinvestment plan.

Table of Contents

Selling Stockholders, Concurrent Resale Registration and Lock-Up Agreements

Selling Stockholders. A preliminary version of this prospectus included 2,353,331 shares offered for the account of various selling stockholders and disclosed that those selling stockholders had the right to withdraw their shares from this offering at any time until the 10th day prior to the effective date of the registration statement of which this prospectus is a part. All of those selling stockholders subsequently exercised their rights to withdraw those shares from this offering.

Resale Registration Statement. We have filed with the SEC a separate registration statement covering the resale of up to 11,500,000 shares of our common stock that were issued in the June 2003 private placement.

Lock-Up Agreements. Pursuant to our registration rights agreement, the holders of the 11,500,000 shares of our common stock issued in our June 2003 private placement are, subject to various exceptions, restricted from selling any of their shares for 60 days from the date of this prospectus, without the prior written consent of Friedman, Billings, Ramsey & Co., Inc. In connection with our June 2003 private placement, most of our directors and officers and some of our other stockholders, including Seneca, which collectively own an aggregate of 297,448 shares of our common stock, entered into individual lock-up agreements which, subject to various exceptions, prevent them from reselling their shares until 90 days after the effective date of the resale registration statement. Some of these shares were purchased in our June 2003 private placement and, as a result, are also subject to the 60-day lock-up restrictions described above. In addition, in connection with this offering, our directors and officers and Seneca, who will collectively own an aggregate of 391,148 shares of our common stock immediately following this offering, have entered into individual lock-up agreements which, subject to various exceptions, will prevent them from reselling their shares until 180 days after the date of this prospectus.

Table of Contents

Summary Financial Data

The following summary financial data are derived from audited financial statements as of April 25, 2003 (inception) and June 30, 2003 and for the period from April 26, 2003 through June 30, 2003, and unaudited financial statements as of September 30, 2003 (as restated), for the period April 26, 2003 through September 30, 2003 (as restated) and for the three months ended September 30, 2003 (as restated). The selected financial data should be read in conjunction with the more detailed information contained in the financial statements and notes thereto and Management s Discussion and Analysis of Financial Condition and Results of Operations included elsewhere in this prospectus. See Note 10 to the financial statements for a discussion of the restatement of the financial information below.

	For the period April 26, 2003 through September 30, 2003 (as restated)	For the three months ended September 30, 2003 (as restated)	For the period April 26, 2003 through June 30, 2003
Statement of Operations Data:			
Revenues:			
Net interest income:			
Interest income	$ 11,449,975	$ 10,777,462	$ 672,513
Interest expense	4,492,077	4,327,390	164,687
Net interest income	6,957,898	6,450,072	507,826
Losses on sales of mortgage-backed securities	(7,830,566)	(7,830,566)	
Expenses:			
Management fee expense to related party	483,208	398,522	84,686
Incentive fee expense to related party	613,247	613,247	
Salaries and benefits	40,508	40,508	
Professional services	347,114	123,237	223,877
Board of directors expense	61,072	39,500	21,572
Insurance expense	163,066	127,617	35,449
Custody expense	48,858	46,038	2,820
Other general and administrative expenses	12,907	10,457	2,450
Total expenses	1,769,980	1,399,126	370,854
Net income (loss)	$ (2,642,648)	$ (2,779,620)	$ 136,972
Basic and diluted earnings (loss) per share	$ (0.32)	$ (0.24)	$ 0.04
Weighted average number of shares outstanding, basic and diluted	8,232,481	11,704,000	3,393,394

	September 30, 2003 (as restated)	June 30, 2003	April 25, 2003 (inception)

Balance Sheet Data:			
Mortgage-backed securities available for sale, at fair value	$ 108,885,768	$ 496,629,963	
Mortgage-backed securities pledged as collateral, at fair value	1,496,209,632	1,217,326,202	
Total mortgage-backed securities, at fair value	1,605,095,400	1,713,956,165	
Total assets	1,831,081,815	1,719,447,359	$ 1,000
Repurchase agreements and margin debt	1,472,875,525	1,154,939,346	
Unsettled security purchases	215,742,419	407,777,017	
Total liabilities	1,691,630,834	1,564,199,247	796
Accumulated other comprehensive loss	(18,248,209)	(4,616,316)	
Total stockholders equity	139,450,981	155,248,112	204
Book value per share	$ 11.91	$ 13.26	$ 0.001

RISK FACTORS

You should carefully consider the risks described below before making an investment decision. Our business, financial condition or results of operations could be harmed by any of these risks. Similarly, these risks could cause the market price of our common stock to decline and you might lose all or part of your investment. Our forward-looking statements in this prospectus are subject to the following risks and uncertainties. Our actual results could differ materially from those anticipated by our forward-looking statements as a result of the risk factors below. The risks described below are not the only ones facing our company. Additional risks not presently known to us or that we currently deem immaterial might also impair our business operations.

Risks Related to Our Business

We have a limited operating history and might not be able to operate our business or implement our operating policies and strategies successfully.

We began operations in June of 2003, and we have a limited operating history. The results of our operations will depend on many factors, including the availability of opportunities for the acquisition of mortgage-related assets, the level and volatility of interest rates, readily accessible short- and long-term funding alternatives in the financial markets and economic conditions. Moreover, delays in investing our net proceeds of this offering may cause our performance to be weaker than other fully invested mortgage REITs pursuing comparable investment strategies. You will not have the opportunity to evaluate the manner in which we invest or the economic merits of particular assets to be acquired. Furthermore, we face the risk that we might not successfully operate our business or implement our operating policies and strategies as described in this prospectus.

We have not yet identified any specific mortgage-backed securities to purchase with the net proceeds of this offering and may be unable to invest a significant portion of such net proceeds on acceptable terms or at all, which could harm our financial condition and operating results.

As of the date of this prospectus, we have not identified any specific mortgage-backed securities which we intend to acquire with the proceeds from this offering. As a result, you will not be able to evaluate the economic merits of any investments we make with the net proceeds of this offering prior to the purchase of your shares. You must rely on our ability to evaluate our investment opportunities.

Until we identify and acquire mortgage-backed securities consistent with our investment guidelines, we intend to temporarily invest the balance of the net proceeds of this offering in readily marketable interest-bearing assets consistent with our intention to qualify as a REIT. We cannot assure you that we will be able to identify mortgage-related assets that meet our investment guidelines or that any investment that we make will produce a positive return on our investment. We may be unable to invest the net proceeds of this offering on acceptable terms or at all.

Our investment guidelines permit us to invest up to 10% of our assets in unrated mortgage-related assets, including mortgage-backed securities rated below investment-grade, which carry a greater likelihood of default or rating downgrade than investments in investment-grade mortgage-backed securities and may cause us to suffer losses.

Our asset acquisition policy provides us with the ability to acquire significant amounts of lower credit quality mortgage-related assets, including mortgage-backed securities that are not rated at least investment grade by at least one nationally-recognized statistical rating organization. Under our policy, up to 10% of our total assets may be non-investment grade mortgage-backed securities or other investments such as leveraged mortgage derivative securities, shares of other REITs, mortgage loans or other mortgage-related investments. If we acquire non-investment-grade mortgage-backed securities, we are more likely to incur losses because the mortgages underlying those securities are made to borrowers possessing lower-quality credit. While all agency certificates are subject to a risk of default, that risk is greater with non-investment grade mortgage-backed securities. In addition, the rating agencies are more likely to downgrade the credit quality of those securities, which would reduce the value of those securities.

Interest rate mismatches between our adjustable-rate and hybrid adjustable-rate mortgage-backed securities and the borrowings used to fund our purchases of such mortgage-backed securities might reduce our net income or result in a loss during periods of changing interest rates.

We invest primarily in adjustable-rate and hybrid adjustable-rate mortgage-backed securities. The mortgages underlying adjustable-rate mortgage-backed securities have interest rates that reset periodically, typically every six months or on an annual basis, based upon market-based indices of interest rates such as U.S. Treasury bonds or LIBOR. The mortgages underlying hybrid adjustable-rate mortgage-backed securities have interest rates that are fixed for the first few years of the loan typically three, five, seven or 10 years and thereafter their interest rates reset periodically similar to the mortgages underlying adjustable-rate mortgage-backed securities. We have funded our acquisitions and expect to fund our future acquisitions of adjustable-rate and hybrid adjustable-rate mortgage-backed securities in part with borrowings that have interest rates based on indices and repricing terms similar to, but with shorter maturities than, the interest rate indices and repricing terms of the adjustable-rate and hybrid adjustable-rate mortgage-backed securities. On September 30, 2003, approximately 97% of our investment portfolio was invested in adjustable-rate or hybrid adjustable-rate mortgage-backed securities having a weighted average term to next rate adjustment of approximately 44 months, while our borrowings had a weighted average term of approximately 254 days. The phrase weighted average term to next rate adjustment refers to the average of the periods of time that must elapse before the interest rates adjust for all of the mortgages underlying our adjustable-rate and hybrid adjustable-rate mortgage-backed securities in our portfolio, which average is weighted in proportion to the book values of the applicable securities. During periods of changing interest rates, this interest rate mismatch between our assets and liabilities could reduce or eliminate our net income and distributions to our stockholders and could cause us to suffer a loss.

Accordingly, in a period of rising interest rates, we could experience a decrease in, or elimination of, net income or a net loss because the interest rates on our borrowings adjust faster than the interest rates on our adjustable-rate mortgage-backed securities.

Increased levels of prepayments on the mortgages underlying our mortgage-backed securities might decrease our net interest income or result in a net loss.

The mortgage-backed securities that we acquire generally represent interests in pools of mortgage loans. The principal and interest payments we receive from our mortgage-backed securities are generally funded by the payments that mortgage borrowers make on those underlying mortgage loans. When borrowers pre-pay their mortgage loans sooner than expected, corresponding prepayments on the mortgage-backed securities occur sooner than expected by the marketplace. Sooner-than-expected prepayments could harm our results of operations in the following ways, among others:

- We seek to purchase mortgage-backed securities that we believe to have favorable risk-adjusted expected returns relative to market interest rates at the time of purchase. If the coupon interest rate for a mortgage-backed security is higher than the market interest rate at the time it is purchased, then that mortgage-backed security will be acquired at a premium to its par value. As of September 30, 2003, all of the mortgage-backed securities in our portfolio were purchased at a premium to their par value and our portfolio had a weighted-average amortized cost of 102.7. In accordance with applicable accounting rules, we are required to amortize any premiums or discounts related to our mortgage-backed securities over their expected terms. The amortization of a premium reduces interest income, while the amortization of a discount increases interest income. The expected terms for mortgage-backed securities are a function of the prepayment rates for the mortgages underlying the mortgage-backed securities. Mortgage-backed securities that are at a premium to their par value are more likely to experience prepayment of some or all of their principal through refinancings. If the mortgages underlying our

14

premium mortgage-backed securities are prepaid in whole or in part more quickly than their respective maturity dates, then we must also amortize their respective premiums more quickly, which would decrease our net interest income and harm our profitability.

A substantial portion of our adjustable-rate mortgage-backed securities may bear interest at rates that are lower than their fully-indexed rates, which refers to their applicable index rates plus a margin. If an adjustable-rate mortgage-backed security is prepaid prior to or soon after the time of adjustment to a fully-indexed rate, we will have held that mortgage-backed security while it was less profitable and lost the opportunity to receive interest at the fully-indexed rate over the remainder of its expected life.

If we are unable to acquire new mortgage-backed securities to replace the prepaid mortgage-backed securities, our financial condition, results of operations and cash flow may suffer and we could incur losses.

Prepayment rates generally increase when interest rates fall and decrease when interest rates rise, but changes in prepayment rates are difficult to predict. Prepayment rates also may be affected by other factors, including, without limitation, conditions in the housing and financial markets, general economic conditions and the relative interest rates on adjustable-rate and fixed-rate mortgage loans. While we seek to minimize prepayment risk, we must balance prepayment risk against other risks and the potential returns of each investment when selecting investments. No strategy can completely insulate us from prepayment or other such risks.

We may incur increased borrowing costs related to repurchase agreements that would harm our results of operations.

Our borrowing costs under repurchase agreements are generally adjustable and correspond to short-term interest rates, such as LIBOR or a short-term Treasury index, plus or minus a margin. The margins on these borrowings over or under short-term interest rates may vary depending upon a number of factors, including, without limitation:

the movement of interest rates;

the availability of financing in the market; and

the value and liquidity of our mortgage-backed securities.

Most of our borrowings are collateralized borrowings in the form of repurchase agreements. If the interest rates on these repurchase agreements increase, our results of operations will be harmed and we may have losses.

Interest rate caps related to our adjustable-rate and hybrid adjustable-rate mortgage-backed securities may reduce our income or cause us to suffer a loss during periods of rising interest rates.

The mortgages underlying our adjustable-rate and hybrid adjustable-rate mortgage-backed securities are typically subject to periodic and lifetime interest rate caps. Periodic interest rate caps limit the amount that the interest rate of a mortgage can increase during any given period. Lifetime interest rate caps limit the amount an interest rate can increase through the maturity of a mortgage. As of September 30, 2003, approximately 97% of our mortgage-backed securities were based on adjustable-rate or hybrid adjustable-rate mortgages, substantially all of which were subject to interest rate caps. The percentage of adjustable-rate and hybrid adjustable-rate mortgage-backed securities in our investment portfolio as of June 30, 2003, and September 30, 2003, which are subject to periodic interest rate caps every six months or annually, are set forth in the following table:

Term of Periodic Reset	**June 30, 2003**	**September 30, 2003**
Six months	12.1%	13.1%
12 months	87.9%	86.9%

Our borrowings are not subject to similar restrictions. The periodic adjustments to the interest rates of the mortgages underlying our adjustable-rate and hybrid adjustable-rate mortgage-backed securities are based on

Table of Contents

changes in an objective index. Substantially all of the mortgages underlying our adjustable-rate and hybrid adjustable-rate mortgage-backed securities adjust their interest rates based on one of two main indices, the U.S. Treasury index, a monthly or weekly average yield of benchmark U.S. Treasury securities as published by the Federal Reserve Board, or LIBOR, the interest rate that banks in London offer for deposits in London of U.S. dollars. The percentages of the mortgages underlying the adjustable-rate and hybrid adjustable-rate mortgage-backed securities in our investment portfolio as of June 30, 2003, and September 30, 2003 with interest rates that reset based on the U.S. Treasury or LIBOR indices are set forth in the table below:

Reference Index	June 30, 2003	September 30, 2003
U.S. Treasury	50.1%	50.8%
LIBOR	49.9%	49.2%

Accordingly, in a period of rapidly increasing interest rates, the interest rates paid on our borrowings could increase without limitation while interest rate caps could limit the increases in the yields on our adjustable-rate and hybrid adjustable-rate mortgage-backed securities. This problem is magnified for adjustable-rate and hybrid adjustable-rate mortgage-backed securities that are not fully indexed. Further, some of the mortgages underlying our adjustable-rate and hybrid adjustable-rate mortgage-backed securities may be subject to periodic payment caps that result in a portion of the interest being deferred and added to the principal outstanding. As a result, we may receive less cash income on adjustable-rate and hybrid adjustable-rate mortgage-backed securities than we need to pay interest on our related borrowings. These factors could reduce our net interest income or cause us to suffer a net loss.

We might experience reduced net interest income or a loss from holding fixed-rate investments during periods of rising interest rates.

A significant portion of our investment portfolio consists of hybrid adjustable-rate mortgage-backed securities. As of September 30, 2003, approximately 84.3% of our investment portfolio consisted of hybrid adjustable-rate mortgage-backed securities. We may also invest in fixed-rate mortgage-backed securities from time to time, however, as of September 30, 2003, none of our portfolio consisted of fixed-rate mortgage-backed securities. We fund our acquisition of fixed-rate mortgage-backed securities, including those based on balloon maturity and hybrid adjustable-rate mortgages, in part with short-term repurchase agreements and term loans. During periods of rising interest rates, our costs associated with borrowings used to fund the acquisition of fixed-rate mortgage-backed securities are subject to increases while the income we earn from these assets remains substantially fixed. This would reduce and could eliminate the net interest spread between the fixed-rate mortgage-backed securities that we purchase and our borrowings used to purchase them, which would reduce our net interest income and could cause us to suffer a loss.

Our leverage strategy increases the risks of our operations, which could reduce our net income and the amount available for distributions or cause us to suffer a loss.

As of September 30, 2003, we had indebtedness of approximately $1.5 billion. We generally seek to borrow between eight and 12 times the amount of our equity, although at times our borrowings may be above or below this amount. We incur this indebtedness by borrowing against a substantial portion of the market value of our mortgage-backed securities. Our total indebtedness, however, is not expressly limited by our policies and will depend on our and our prospective lender s estimate of the stability of our portfolio s cash flow. We face the risk that we might not be able to meet our debt service obligations or a lender s margin requirements from our income and, to the extent we cannot, we might be forced to liquidate some of our assets at disadvantageous prices. Our use of leverage amplifies the risks associated with other risk factors, which could reduce our net income and the amount available for distributions or cause us to suffer a loss. For example:

A majority of our borrowings are secured by our mortgage-backed securities, generally under repurchase agreements. A decline in the market value of the mortgage-backed securities used to secure

Table of Contents

these debt obligations could limit our ability to borrow or result in lenders requiring us to pledge additional collateral to secure our borrowings. In that situation, we could be required to sell mortgage-backed securities under adverse market conditions in order to obtain the additional collateral required by the lender. If these sales are made at prices lower than the carrying value of the mortgage-backed securities, we would experience losses.

A default under a mortgage-related asset that constitutes collateral for a loan could also result in an involuntary liquidation of the mortgage-related asset, including any cross-collateralized mortgage-backed securities. This would result in a loss to us of the difference between the value of the mortgage-related asset upon liquidation and the amount borrowed against the mortgage-related asset.

To the extent we are compelled to liquidate qualified REIT assets to repay debts, our compliance with the REIT rules regarding our assets and our sources of income could be negatively affected, which would jeopardize our status as a REIT. Losing our REIT status would cause us to lose tax advantages applicable to REITs and would decrease our overall profitability and distributions to our stockholders.

If we experience losses as a result of our leverage policy, such losses would reduce the amounts available for distribution to our stockholders.

We might not be able to use derivatives to mitigate our interest rate and prepayment risks.

Our policies permit us to enter into interest rate swaps, caps and floors and other derivative transactions to help us reduce our interest rate and prepayment risks. As of September 30, 2003, we were not a counterparty to any derivative arrangements. On November 21, 2003, we engaged in a short sale of Euro dollar futures contracts in order to hedge the impact of changes in interest rates on our liability costs. In the future, these transactions might mitigate our interest rate and prepayment risks, but cannot eliminate these risks. Moreover, the use of derivative transactions could have a negative impact on our earnings and our status as a REIT, and, therefore, our use of such derivatives could be limited.

We may enter into ineffective derivative transactions or other hedging activities that may reduce our net interest income or cause us to suffer losses.

Our policies permit us to, but we are not required to, enter into derivative transactions such as interest rate swaps, caps and floors and other derivative transactions to help us seek to reduce our interest rate and prepayment risks. The effectiveness of any derivative transactions will depend significantly upon whether we correctly quantify the interest rate or prepayment risks being hedged, our execution of and ongoing monitoring of our hedging activities, and the treatment of such hedging activities for GAAP accounting purposes.

Subsequent to September 30, 2003, we engaged in short sales of Euro dollar futures contracts in order to hedge the impact of changes in interest rates on our liability costs. We sold short 1,725 Euro dollar futures contracts, which expire in March 2004, June 2004 and September 2004, with a notional amount totaling $1,725.0 million. In the case of these hedges, and any other future efforts to hedge the effects of interest rate changes on our liability costs, if we enter into hedging instruments that have higher interest rates embedded in them as a result of the forward yield curve, and at the end of the term of these hedging instruments the spot market interest rates for the liabilities that we hedged are actually lower, then we will have locked in higher interest rates for our liabilities than would be available in the spot market at the time and this could result in a narrowing of our net interest rate margin or result in losses. In some situations, we may sell assets or hedging instruments at a loss in order to maintain adequate liquidity.

In addition, we will apply SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended and interpreted, and record any derivatives at fair value. If the derivatives meet the criteria to be accounted for as hedging transactions, the effects of the transactions could be materially different as to timing than if they do not qualify as hedges, and this may cause a narrowing of our net interest rate margin or result in losses.

Table of Contents

An increase in interest rates might adversely affect our book value.

We use changes in 10-year U.S. Treasury yields as a reference indicator for changes in interest rates because it is a common market benchmark. Between June 1, 2003 and September 30, 2003, the 10-year U.S. Treasury yield ranged from a low of 3.11% on June 13, 2003 to a high of 4.60% on September 2, 2003, an increase of approximately 48%. Increases in the general level of interest rates can cause the fair market value of our assets to decline, particularly those mortgage-backed securities whose underlying mortgages have fixed-rate components. Our fixed-rate mortgage securities and our hybrid adjustable-rate mortgage-backed securities (during the fixed-rate component of the mortgages underlying such securities) will generally be more negatively affected by such increases than our adjustable-rate mortgage securities. In accordance with GAAP, we will be required to reduce the carrying value of our mortgage-backed securities by the amount of any decrease in the fair value of our mortgage-backed securities compared to their respective amortized costs. If unrealized losses in fair value occur, we will have to either reduce current earnings or reduce stockholders equity without immediately affecting current earnings, depending on how we classify such mortgage-backed securities under GAAP. In either case, our net book value will decrease to the extent of any realized or unrealized losses in fair value.

We may invest in leveraged mortgage derivative securities that generally experience greater volatility in market prices, and thus expose us to greater risk with respect to their rate of return.

We may acquire leveraged mortgage derivative securities that expose us to a high level of interest rate risk. The characteristics of leveraged mortgage derivative securities cause those securities to experience greater volatility in their market prices. Thus, acquisition of leveraged mortgage derivative securities will expose us to the risk of greater volatility in our portfolio, which could reduce our net income and harm our overall results of operations.

We depend on borrowings to purchase mortgage-related assets and reach our desired amount of leverage. If we fail to obtain or renew sufficient funding on favorable terms or at all, we will be limited in our ability to acquire mortgage-related assets, which will harm our results of operations.

We depend on short-term borrowings to fund acquisitions of mortgage-related assets and reach our desired amount of leverage. Accordingly, our ability to achieve our investment and leverage objectives depends on our ability to borrow money in sufficient amounts and on favorable terms. In addition, we must be able to renew or replace our maturing short-term borrowings on a continuous basis. We depend on a few lenders to provide the primary credit facilities for our purchases of mortgage-related assets. In addition, our existing indebtedness may limit our ability to make additional borrowings. If our lenders do not allow us to renew our borrowings or we cannot replace maturing borrowings on favorable terms or at all, we might have to sell our mortgage-related assets under adverse market conditions, which would harm our results of operations and may result in permanent losses.

Possible market developments could cause our lenders to require us to pledge additional assets as collateral. If our assets are insufficient to meet the collateral requirements, we might be compelled to liquidate particular assets at inopportune times and at disadvantageous prices.

Possible market developments, including a sharp or prolonged rise in interest rates, a change in prepayment rates or increasing market concern about the value or liquidity of one or more types of mortgage-backed securities in which our portfolio is concentrated, might reduce the market value of our portfolio, which might cause our lenders to require additional collateral. Any requirement for additional collateral might compel us to liquidate our assets at inopportune times and at disadvantageous prices, thereby harming our operating results. If we sell mortgage-backed securities at prices lower than the carrying value of the mortgage-backed securities, we would experience losses.

Our use of repurchase agreements to borrow funds may give our lenders greater rights in the event that either we or any of our lenders file for bankruptcy.

Our borrowings under repurchase agreements may qualify for special treatment under the bankruptcy code, giving our lenders the ability to avoid the automatic stay provisions of the bankruptcy code and to take possession of and liquidate our collateral under the repurchase agreements without delay if we file for bankruptcy. Furthermore, the special treatment of repurchase agreements under the bankruptcy code may make it difficult for us to recover our pledged assets in the event that our lender files for bankruptcy. Thus, the use of repurchase agreements exposes our pledged assets to risk in the event of a bankruptcy filing by either our lender or us.

Because the assets that we acquire might experience periods of illiquidity, we might be prevented from selling our mortgage-related assets at opportune times and prices.

We bear the risk of being unable to dispose of our mortgage-related assets at advantageous times and prices or in a timely manner because mortgage-related assets generally experience periods of illiquidity. The lack of liquidity might result from the absence of a willing buyer or an established market for these assets, as well as legal or contractual restrictions on resale. If we are unable to sell our mortgage-related assets at opportune times, we might suffer a loss and/or reduce our distributions.

Our board of directors may change our operating policies and strategies without prior notice or stockholder approval and such changes could harm our business and results of operations and the value of our stock.

Our board of directors has the authority to modify or waive our current operating policies and our strategies (including our election to operate as a REIT) without prior notice and without stockholder approval. We cannot predict the effect any changes to our current operating policies and strategies would have on our business, operating results and value of our stock. However, the effects might be adverse.

Competition might prevent us from acquiring mortgage-backed securities at favorable yields, which would harm our results of operations.

Our net income depends on our ability to acquire mortgage-backed securities at favorable spreads over our borrowing costs. In acquiring mortgage-backed securities, we compete with other REITs, investment banking firms, savings and loan associations, banks, insurance companies, mutual funds, other lenders and other entities that purchase mortgage-backed securities, many of which have greater financial resources than we do. As a result, we may not be able to acquire sufficient mortgage-backed securities at favorable spreads over our borrowing costs, which would harm our results of operations.

Defaults on the mortgage loans underlying our mortgage-backed securities may reduce the value of our investment portfolio and may harm our results of operations.

We bear the risk of any losses resulting from any defaults on the mortgage loans underlying the mortgage-backed securities in our investment portfolio. Many of the mortgage-backed securities that we obtain will have one or more forms of credit enhancement provided by third parties, such as insurance against risk of loss due to default on the underlying mortgage loans or bankruptcy, fraud and special hazard losses. To the extent that third parties have been contracted to insure against these types of losses, the value of such insurance will depend in part on the creditworthiness and claims-paying ability of the insurer and the timeliness of reimbursement in the event of a default on the underlying obligations. Further, the insurance coverage for various types of losses is limited in amount, and losses in excess of these limitations would be borne by us.

Other mortgage-backed securities that we purchase will be subject to limited guarantees of the payment of limited amounts of principal and interest on mortgage loans underlying such mortgage-backed securities, either by federal government agencies, including Ginnie Mae, by federally-chartered corporations, including Fannie Mae and Freddie Mac, or by other corporate guarantors. While Ginnie Mae s obligations are backed by the full faith and credit of the United States, the obligations of Fannie Mae and Freddie Mac and other corporate guarantors are solely their own. As a result, a substantial deterioration in the financial strength of Fannie Mae,

19

Table of Contents

Freddie Mac or other corporate guarantors could increase our exposure to future delinquencies, defaults or credit losses on our holdings of Fannie Mae or Freddie Mac-backed mortgage-backed securities or other corporate-backed mortgage-backed securities, and could harm our results of operations. In addition, while Freddie Mac guarantees the eventual payment of principal, it does not guarantee the timely payment thereof, and our results of operations may be harmed if borrowers are late or delinquent in their payments on mortgages underlying Freddie Mac-backed mortgage-backed securities. Moreover, Fannie Mae, Freddie Mac, Ginnie Mae and other corporate guarantees relate only to payments of limited amounts of principal and interest on the mortgages underlying such agency-backed or corporate-backed securities, and do not guarantee the market value of such mortgage-backed securities or the yields on such mortgage-backed securities. As a result, we remain subject to interest rate risks, prepayment risks, extension risks and other risks associated with our investment in such mortgage-backed securities and may experience losses in our investment portfolio.

We remain subject to losses despite our strategy of investing in highly-rated mortgage-backed securities.

Our investment guidelines provide that at least 90% of our assets must be invested in mortgage-backed securities that are either agency-backed or are rated at least investment grade by at least one rating agency. While highly-rated mortgage-backed securities are generally subject to a lower risk of default than lower credit quality mortgage-backed securities and may benefit from third-party credit enhancements such as insurance or corporate guarantees, there is no assurance that such mortgage-backed securities will not be subject to credit losses. Furthermore, ratings are subject to change over time as a result of a number of factors, including greater than expected delinquencies, defaults or credit losses, or a deterioration in the financial strength of corporate guarantors, any of which may reduce the market value of such securities. Furthermore, ratings do not take into account the reasonableness of the issue price, interest risks, prepayment risks, extension risks or other risks associated with such mortgage-backed securities. As a result, while we attempt to mitigate our exposure to credit risk on a relative basis by focusing on highly-rated mortgage-backed securities, we cannot eliminate such credit risks and remain subject to other risks to our investment portfolio and may suffer losses, which may harm the market price of our common stock.

Decreases in the value of the property underlying our mortgage-backed securities might decrease the value of our assets.

The mortgage-backed securities in which we invest are secured by underlying real property interests. To the extent that the value of the property underlying our mortgage-backed securities decreases, our security might be impaired, which might decrease the value of our assets.

Insurance will not cover all potential losses on the underlying real property and the absence thereof may harm the value of our assets.

Under our asset acquisition policy, we are permitted to invest up to a maximum of 10% of our total assets in assets other than mortgage-backed securities guaranteed by federal agencies or federally chartered entities such as Fannie Mae, Freddie Mac or Ginnie Mae, or rated as at least investment grade by a nationally recognized statistical rating agency. Mortgage loans fall outside of this category of investments under our investment guidelines and are subject to the 10% limitation. If we elect in the future to purchase mortgage loans, we may require that each of the mortgage loans that we purchase include comprehensive insurance covering the underlying real property, including liability, fire and extended coverage. There are certain types of losses, however, generally of a catastrophic nature, such as earthquakes, floods and hurricanes, that may be uninsurable or not economically insurable. Inflation, changes in building codes and ordinances, environmental considerations, and other factors also might make it infeasible to use insurance proceeds to replace a property if it is damaged or destroyed. Under such circumstances, the insurance proceeds, if any, might not be adequate to restore the economic value of the underlying real property, which might impair our security and decrease the value of our assets.

Table of Contents

Distressed mortgage loans have higher risk of future default.

If we elect in the future to purchase mortgage loans, we may purchase distressed mortgage loans as well as mortgage loans that have had a history of delinquencies. These distressed mortgage loans may be in default or may have a greater than normal risk of future defaults and delinquencies, as compared to a pool of newly-originated, high quality loans of comparable type, size and geographic concentration. Returns on an investment of this type depend on accurate pricing of such investment, the borrower s ability to make required payments or, in the event of default, the ability of the loan s servicer to foreclose and liquidate the mortgage loan. We cannot assure you that the servicer will be able to liquidate a defaulted mortgage loan in a cost-effective manner, at an advantageous price or in a timely manner.

Subordinated loans on real estate are subject to higher risks.

If we elect in the future to purchase mortgage loans, we may acquire loans secured by commercial properties, including loans that are subordinate to first liens on the underlying commercial real estate. Subordinated mortgage loans are subject to greater risks of loss than first lien mortgage loans. An overall decline in the real estate market could reduce the value of the real property securing such loans such that the aggregate outstanding balance of the second-lien loan and the balance of the more senior loan on the real property exceed the value of the real property.

We depend on our key personnel and the loss of any of our key personnel could severely and detrimentally affect our operations.

We depend on the diligence, experience and skill of our officers and the people working on behalf of our manager for the selection, acquisition, structuring and monitoring of our mortgage-related assets and associated borrowings. Our key officers include Gail Seneca, Albert Gutierrez, Christopher Zyda, Andrew Chow and Troy Grande. We have not entered into employment agreements with our senior officers other than Mr. Zyda, who is our senior vice president and chief financial officer. With the exception of Mr. Zyda, we do not currently employ personnel dedicated solely to our business, and our officers (other than Mr. Zyda) are free to engage in competitive activities in our industry. The loss of any key person could harm our business, financial condition, cash flow and results of operations.

Risks Related to Our Manager

Seneca has not managed a REIT and we cannot assure you that Seneca s past experience will be sufficient to successfully manage our business as a REIT.

Seneca Capital Management LLC has not previously managed a REIT, and does not have any experience in complying with the income, asset and other limitations imposed by the REIT provisions of the Internal Revenue Code. Those provisions are complex and the failure to comply with those provisions in a timely manner could prevent us from qualifying as a REIT or could force us to pay unexpected taxes and penalties. In such event, our net income would be reduced and we could incur a loss.

Our manager has significant influence over our affairs, and might cause us to engage in transactions that are not in our or our stockholders best interests.

In addition to managing us and having at least two of its designees as members of our board, Seneca provides advice on our operating policies and strategies. Seneca may also cause us to engage in future transactions with Seneca and its affiliates, subject to the approval of, or guidelines approved by, the independent members of our board of directors. Our directors, however, rely primarily on information supplied by our manager in reaching their determinations. Accordingly, our manager has significant influence over our affairs, and may cause us to engage in transactions which are not in our best interest.

Table of Contents

Our manager and its affiliates might allocate mortgage-related opportunities to other entities, and thus might divert attractive investment opportunities away from us.

Our operations and assets are managed by specified individuals at Seneca. Seneca and its affiliates, including some of our officers, manage portfolios for parties unrelated to us. These multiple responsibilities might create conflicts of interest for Seneca and these individuals if they are presented with opportunities that might benefit us and their other clients. Seneca and these individuals must allocate investments among our portfolio and their other clients by determining the entity or account for which the investment is most suitable. In making this determination, Seneca and these individuals consider the investment strategy and guidelines of each entity or account with respect to acquisition of assets, leverage, liquidity and other factors that Seneca and these individuals determine appropriate. However, Seneca and those working on its behalf have no obligation to make any specific investment opportunities available to us and the above-mentioned conflicts of interest might result in decisions or allocations of investments that are not in our or our stockholders best interests.

We will pay Seneca incentive compensation based on our portfolio s performance. This arrangement may lead Seneca to recommend riskier or more speculative investments in an effort to maximize its incentive compensation.

In addition to its base management fee, Seneca earns incentive compensation for each fiscal quarter equal to a specified percentage of the amount by which our return on equity, before deducting incentive compensation, exceeds a return based on the 10 year U.S. Treasury rate plus 2%. The percentage for this calculation is the weighted average of the following percentages based on our average net invested assets for the period:

- 20% for the first $400 million of our average net invested assets; and
- 10% of our average net invested assets in excess of $400 million.

Since the time that we commenced our operations in June 2003, we have not paid Seneca any incentive compensation. However, during the quarter ended September 30, 2003 Seneca earned, but subsequently waived its right to receive, incentive fees of $613,247. The waived incentive fee was expensed in the quarter ended September 30, 2003 and has been accounted for as a capital contribution as of September 30, 2003. Seneca s waiver applies only to the third quarter of 2003.

Pursuant to the formula for calculating Seneca s incentive compensation, Seneca shares in our profits but not in our losses. Consequently, as Seneca evaluates different mortgage-backed securities and other investments for our account, there is a risk that Seneca will cause us to assume more risk than is prudent in an attempt to increase its incentive compensation. Other key criteria related to determining appropriate investments and investment strategies, including the preservation of capital, might be under-weighted if Seneca focuses exclusively or disproportionately on maximizing its income.

We may be obligated to pay Seneca incentive compensation even if we incur a loss.

Pursuant to the management agreement, Seneca is entitled to receive incentive compensation for each fiscal quarter in an amount equal to a tiered percentage of the excess of our taxable income for that quarter (before deducting incentive compensation, net operating losses and certain other items) above a threshold return for that quarter. In addition, the management agreement further provides that our taxable income for incentive compensation purposes excludes net capital losses that we may incur in the fiscal quarter, even if such capital losses result in a net loss on our statement of operations for that quarter. Thus, we may be required to pay Seneca incentive compensation for a fiscal quarter even if there is a decline in the value of our portfolio or we incur a net loss for that quarter. For example, we incurred a net loss for the quarter ended September 30, 2003 of $2.8 million, however, taxable income for purposes of calculating the incentive compensation for the same period was $6.0 million. As a result, taxable income for incentive compensation purposes was greater than the threshold return taxable income of $2.9 million and, therefore, incentive compensation of $613,247 was earned by Seneca. Although Seneca was entitled to receive incentive compensation for the quarter ended September 30, 2003, Seneca voluntarily waived on a one-time basis its right to incentive compensation for this period. There is no expectation that Seneca will waive its right to incentive compensation in the future.

Table of Contents

During periods of declining market prices for shares of our common stock, we may be required to issue greater numbers of shares to Seneca for the same amount of incentive compensation arising under the management agreement, which will have a dilutive effect on our stockholders that may harm the market price of our common stock.

Pursuant to the terms of the management agreement, the incentive compensation payable to Seneca for each fiscal quarter is paid one-half in cash and one-half in restricted shares of our common stock. The number of shares to be issued to Seneca is based on (a) one-half of the total incentive compensation for the period, divided by (b) the fair value of the shares on the last date of the period for which the incentive compensation is calculated, less a fair market value discount determined by our board of directors. During periods of declining market prices for shares of our common stock, we may be required to issue more shares to Seneca for the same amount of incentive compensation. Although these shares will initially be subject to restrictions on transfer which lapse ratably over a three-year period, the issuance of these shares will have a dilutive effect on our stockholders which may harm the market price of our common stock.

Because Seneca might receive a significant fee if we terminate the management agreement, economic considerations might preclude us from terminating the management agreement in the event that Seneca fails to meet our expectations.

If we terminate the management agreement without cause or because we decide to manage our company internally or if Seneca terminates the management in the event of a change of control, then we will have to pay a significant fee to Seneca. The amount of the fee depends on whether:

- we terminate the management agreement without cause in connection with a decision to manage our portfolio internally, in which case we will be obligated to pay to Seneca a fee equal to the highest amount of management fees incurred in a particular year during the then three most recent years; or

- our decision to terminate the management agreement without cause is for a reason other than our decision to manage our portfolio internally, in which case we will be obligated to pay Seneca an amount equal to two times the highest amount of management fees incurred in a particular year during the then three most recent years.

In each of the above cases, Seneca will also receive accelerated vesting of the equity component of its incentive compensation. The actual amount of such fee cannot be known at this time because it is based in part on the performance of our portfolio of mortgage-backed securities. Paying this fee would reduce significantly the cash available for distribution to our stockholders and might cause us to suffer a net operating loss. Consequently, terminating the management agreement might not be advisable even if we determine that it would be more efficient to operate with an internal management structure or if we are otherwise dissatisfied with Seneca s performance.

Investors may not be able to estimate with certainty the aggregate fees and expense reimbursements that will be paid to Seneca under the management agreement and the cost-sharing agreement due to the time and manner in which Seneca s incentive compensation and expense reimbursements are determined.

Seneca may be entitled to substantial fees pursuant to the management agreement. Seneca s base management fee is calculated as a percentage of our average net worth. We accrued a base management fee payable to Seneca of $84,686 for the three months ended June 30, 2003, and have accrued base management fees of $398,522 for the three months ended September 30, 2003. Seneca s incentive compensation is calculated as a tiered percentage of our taxable income (before deducting certain items) in excess of a threshold amount of taxable income and is indeterminable in advance of a particular period. We have not paid Seneca any incentive compensation for the three months ended June 30, 2003 and, for the three months ended September 30, 2003 Seneca waived its right to incentive compensation. The incentive fee was expensed in the quarter ended

September 30, 2003 and the waived incentive fee has been accounted for as a capital contribution as of September 30, 2003. From inception through September 30, 2003, aggregate out-of-pocket expenses that have

23

been accrued and/or paid to Seneca and/or its affiliates under the management agreement and expenses accrued for reimbursement to Seneca but not yet paid under the cost-sharing agreement were approximately $1.2 million and $1,993, respectively. Since future payments of base management fees, incentive compensation and expense reimbursements are determined at future dates based upon our then-applicable average net worth, results of operations and actual expenses incurred by Seneca, such fees and expense reimbursements cannot be estimated with mathematical certainty. Any base management fees, incentive compensation or expense reimbursements payable to Seneca may be materially greater or less than the historical amounts set forth above and we can provide no assurance at this time as to the amount of any such base management fee, incentive compensation or expense reimbursements that may be payable to Seneca in the future.

Seneca may render services to other mortgage investors, which could reduce the amount of time and effort that Seneca devotes to us.

Our management agreement with Seneca does not restrict the right of Seneca, any persons working on its behalf or any of its affiliates, to carry on their respective businesses, including the rendering of advice to others regarding the purchase of mortgage-backed securities that would meet our investment criteria. In addition, the management agreement does not specify a minimum time period that Seneca and its personnel must devote to managing our investments. The ability of Seneca to engage in these other business activities, and specifically to manage mortgage-related assets for third parties, could reduce the time and effort it spends managing our portfolio to the detriment of our investment returns.

Seneca s liability is limited under the management agreement, and we have agreed to indemnify Seneca against certain liabilities.

Seneca has not assumed any responsibility to us other than to render the services described in the management agreement, and will not be responsible for any action of our board of directors in declining to follow Seneca s advice or recommendations. Seneca and its directors, officers and employees will not be liable to us for acts performed by its officers, directors, or employees in accordance with and pursuant to the management agreement, except for acts constituting gross negligence, recklessness, willful misconduct or active fraud in connection with their duties under the management agreement. We have agreed to indemnify Seneca and its directors, officers and employees with respect to all expenses, losses, damages, liabilities, demands, charges and claims arising from acts of Seneca not constituting gross negligence, recklessness, willful misconduct or active fraud.

Legal and Tax Risks

If we are disqualified as a REIT, we will be subject to tax as a regular corporation and face substantial tax liability.

Qualification as a REIT involves the application of highly technical and complex U.S. federal income tax code provisions for which only a limited number of judicial or administrative interpretations exist. Accordingly, it is not certain we will be able to become and remain qualified as a REIT for U.S. federal income tax purposes. Even a technical or inadvertent mistake could jeopardize our REIT status. Furthermore, Congress or the Internal Revenue Service, or IRS, might change tax laws or regulations and the courts might issue new rulings, in each case potentially having retroactive effect, that could make it more difficult or impossible for us to qualify as a REIT. If we fail to qualify as a REIT in any tax year, then:

- we would be taxed as a regular domestic corporation, which, among other things, means that we would be unable to deduct distributions to stockholders in computing taxable income and we would be subject to U.S. federal income tax on our taxable income at regular corporate rates;

any resulting tax liability could be substantial, would reduce the amount of cash available for distribution to stockholders, and could force us to liquidate assets at inopportune times, causing lower income or higher losses than would result if these assets were not liquidated; and

Table of Contents

unless we were entitled to relief under applicable statutory provisions, we would be disqualified from treatment as a REIT for the subsequent four taxable years following the year during which we lost our qualification and, thus, our cash available for distribution to our stockholders would be reduced for each of the years during which we did not qualify as a REIT.

Even if we remain qualified as a REIT, we might face other tax liabilities that reduce our cash flow. Further, we might be subject to federal, state and local taxes on our income and property. Any of these taxes would decrease cash available for distribution to our stockholders.

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

In order to qualify as a REIT for U.S. federal income tax purposes, we must satisfy tests concerning, among other things, our sources of income, the nature and diversification of our mortgage-backed securities, the amounts we distribute to our stockholders and the ownership of our stock. We may also be required to make distributions to our stockholders at disadvantageous times or when we do not have funds readily available for distribution. Thus, compliance with REIT requirements may cause us to forego opportunities we would otherwise pursue.

In addition, the REIT provisions of the Internal Revenue Code impose a 100% tax on income from prohibited transactions. Prohibited transactions generally include sales of assets that constitute inventory or other property held for sale in the ordinary course of a business, other than foreclosure property. This 100% tax could impact our desire to sell mortgage-backed securities at otherwise opportune times if we believe such sales could be considered a prohibited transaction.

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

The existing REIT provisions of the Internal Revenue Code substantially limit our ability to hedge mortgage-backed securities and related borrowings. Under these provisions, our annual income from qualified hedges, together with any other income not generated from qualified REIT real estate assets, is limited to less than 25% of our gross income. In addition, we must limit our aggregate income from hedging and services from all sources, other than from qualified REIT real estate assets or qualified hedges, to less than 5% of our annual gross income. As a result, we might in the future have to limit our use of advantageous hedging techniques. This could leave us exposed to greater risks associated with changes in interest rates than we would otherwise want to bear. If we were to violate the 25% or 5% limitations, we might have to pay a penalty tax equal to the amount of our income in excess of those limitations, multiplied by a fraction intended to reflect our profitability. If we fail to satisfy the 25% or 5% limitations, unless our failure was due to reasonable cause and not due to willful neglect, we could lose our REIT status for federal income tax purposes.

Complying with REIT requirements may force us to liquidate otherwise attractive investments.

In order to qualify as a REIT, we must ensure that at the end of each calendar quarter at least 75% of the value of our assets consists of cash, cash items, government securities and qualified REIT real estate assets. The remainder of our investment in securities generally cannot include more than 10% of the outstanding voting securities of any one issuer or more than 10% of the total value of the outstanding securities of any one issuer. In addition, generally, no more than 5% of the value of our assets can consist of the securities of any one issuer. If we fail to comply with these requirements, we must dispose of a portion of our assets within 30 days after the end of the calendar quarter in order to avoid losing our REIT status and suffering adverse tax consequences.

Complying with REIT requirements may force us to borrow to make distributions to our stockholders.

As a REIT, we must distribute 90% of our annual taxable income (subject to certain adjustments) to our stockholders. From time to time, we might generate taxable income greater than our net income for financial

Table of Contents

reporting purposes from, among other things, amortization of capitalized purchase premiums, or our taxable income might be greater than our cash flow available for distribution to our stockholders. If we do not have other funds available in these situations, we might be unable to distribute 90% of our taxable income as required by the REIT rules. In that case, we would need to borrow funds, sell a portion of our mortgage-backed securities potentially at disadvantageous prices or find another alternative source of funds. These alternatives could increase our costs or reduce our equity and reduce amounts available to invest in mortgage-backed securities.

Failure to maintain an exemption from the Investment Company Act, would harm our results of operations.

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 fail to qualify for this exemption, our ability to use leverage would be substantially reduced and we would be unable to conduct our business as described in this prospectus.

The Investment Company Act exempts entities that are primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on, and interests in, real estate. Under the current interpretation of the SEC staff, in order to qualify for this exemption, we must maintain at least 55% of our assets directly in these qualifying real estate interests. Mortgage-backed securities that do not represent all of the certificates issued with respect to an underlying pool of mortgages may be treated as separate from the underlying mortgage loans and, thus, may not qualify for purposes of the 55% requirement. Therefore, our ownership of these mortgage-backed securities is limited by the provisions of the Investment Company Act.

In satisfying the 55% requirement under the Investment Company Act, we treat as qualifying interests mortgage-backed securities issued with respect to an underlying pool as to which we hold all issued certificates. If the SEC or its staff adopts a contrary interpretation of such treatment, we could be required to sell a substantial amount of our mortgage-backed securities under potentially adverse market conditions. Further, in our attempts to ensure that we at all times qualify for the exemption under the Investment Company Act, we might be precluded from acquiring mortgage-backed securities if their yield is higher than the yield on mortgage-backed securities that could be purchased in a manner consistent with the exemption. These factors may lower or eliminate our net income.

Misplaced reliance on legal opinions or statements by issuers of mortgage-backed securities could result in a failure to comply with REIT income or assets tests.

When purchasing mortgage-backed securities, we may rely on opinions of counsel for the issuer or sponsor of such securities, or statements made in related offering documents, for purposes of determining whether and to what extent those securities constitute REIT real estate assets for purposes of the REIT asset tests and produce income that qualifies under the REIT gross income tests. The inaccuracy of any such opinions or statements may adversely affect our REIT qualification and result in significant corporate-level tax.

One-action rules may harm the value of the underlying property.

Several states have laws that prohibit more than one action to enforce a mortgage obligation, and some courts have construed the term action broadly. In such jurisdictions, if the judicial action is not conducted according to law, there may be no other recourse in enforcing a mortgage obligation, thereby decreasing the value of the underlying property.

We may be harmed by changes in various laws and regulations.

Changes in the laws or regulations governing Seneca or its affiliates may impair Seneca s or its affiliates ability to perform services in accordance with the management agreement. Our business may be harmed by

Table of Contents

changes to the laws and regulations affecting our manager or us, including changes to securities laws and changes to the Internal Revenue Code applicable to the taxation of REITs. New legislation may be enacted into law or new interpretations, rulings or regulations could be adopted, any of which could harm us, our manager and our stockholders, potentially with retroactive effect.

Legislation was recently enacted that reduces the maximum tax rate of non-corporate taxpayers for capital gains (for taxable years ending on or after May 6, 2003 and before January 1, 2009) and for dividends (for taxable years beginning after December 31, 2002 and before January 1, 2009) to 15%. Generally, dividends paid by REITs are not eligible for the new 15% federal income tax rate, with certain exceptions discussed at United States Federal Income Tax Considerations Taxation of Taxable United States Stockholders Distributions Generally. Although this legislation does not adversely affect the taxation of REITs or dividends paid by REITs, the more favorable treatment of regular corporate dividends could cause investors who are individuals to consider stocks of other corporations that pay dividends as more attractive relative to stocks of REITs. It is not possible to predict whether this change in perceived relative value will occur, or what the effect will be on the market price of our common stock.

In addition, legislation was recently introduced in the United States House of Representatives and the United States Senate that would amend certain rules relating to REITs. Among other changes, the proposed legislation would provide the Internal Revenue Service with the ability to impose monetary penalties, rather than a loss of REIT status, for reasonable cause violations of certain tests relating to REIT qualification, and would change the formula for calculating the tax imposed for certain violations of the income tests discussed at United States Federal Income Tax Considerations Requirements for Qualification as a REIT Income Tests. In general, the changes would apply to taxable years beginning after the date the legislation is enacted. As of the date hereof, it is not possible to predict with any certainty whether the proposed legislation will be enacted in its current form.

We may incur excess inclusion income that would increase the tax liability of our stockholders.

In general, dividend income that a tax-exempt entity receives from us should not constitute unrelated business taxable income as defined in Section 512 of the Internal Revenue Code. If we realize excess inclusion income and allocate it to stockholders, this income cannot be offset by net operating losses. If the stockholder is a tax-exempt entity, then this income would be fully taxable as unrelated business taxable income under Section 512 of the Internal Revenue Code. If the stockholder is foreign, it would be subject to U.S. federal income tax withholding on this income without reduction pursuant to any otherwise applicable income-tax treaty.

Excess inclusion income could result if we held a residual interest in a real estate mortgage investment conduit, or REMIC. Excess inclusion income also would be generated if we were to issue debt obligations with two or more maturities and the terms of the payments on these obligations bore a relationship to the payments that we received on our mortgage-backed securities securing those debt obligations. We generally structure our borrowing arrangements in a manner designed to avoid generating significant amounts of excess inclusion income. We do, however, enter into various repurchase agreements that have differing maturity dates and afford the lender the right to sell any pledged mortgage securities if we default on our obligations. The IRS may determine that these borrowings give rise to excess inclusion income that should be allocated among stockholders. Furthermore, some types of tax-exempt entities, including voluntary employee benefit associations and entities that have borrowed funds to acquire their shares of our common stock, may be required to treat a portion of or all of the dividends they may receive from us as unrelated business taxable income. Finally, we may invest in equity securities of other REITs and it is possible that we might receive excess inclusion income from those investments.

Table of Contents

Risks Related to this Offering

We have not established a minimum distribution payment level and we cannot assure you of our ability to make distributions to our stockholders in the future.

We intend to make quarterly distributions to our stockholders in amounts such that we distribute all or substantially all of our taxable income in each year, subject to certain adjustments. This, along with other factors, should enable us to qualify for the tax benefits accorded to a REIT under the Internal Revenue Code. We have not established a minimum distribution payment level and our ability to make distributions might be harmed by the risk factors described in this prospectus. All distributions will be made at the discretion of our board of directors and will depend on our earnings, our financial condition, maintenance of our REIT status and such other factors as our board of directors may deem relevant from time to time. We cannot assure you that we will have the ability to make distributions to our stockholders in the future.

Our ability to pay our declared cash distribution for the fourth quarter of 2004 depends upon our actual operating results for the quarter. If our actual results are below our expectations, we will need to sell assets or borrow funds to pay the distribution.

On November 24, 2003 our board of directors declared a cash distribution of $0.45 per share for the fourth quarter of 2003, payable on January 28, 2004 to stockholders of record on December 11, 2003. This offering will close after the distribution record date and, accordingly, purchasers of common stock in this offering will not receive the distribution.

This distribution declaration for the fourth quarter 2003 is irrevocable and is not contingent on our operating performance. If we do not generate sufficient cash flow from ongoing operations (including principal payments and interest payments on our mortgage-backed securities) to fund the distribution, we will need to sell mortgage-backed securities or borrow funds by entering into repurchase agreements or otherwise borrowing funds under our line of credit to pay the distribution. If we were to borrow funds on a regular basis to make distributions in excess of operating cash flow, it is likely that our results of operations and our stock price would be adversely affected.

If this distribution causes our aggregate distributions in fiscal year 2003 to exceed our earnings and profits for 2003 (as determined under the tax code), such excess should, for REIT qualification purposes, be treated as a distribution in 2004. In that case, our REIT-related distribution requirement for 2004 would be reduced by the amount of such excess. Any reduction to our 2004 REIT-related distribution requirement could cause our total 2004 distributions to stockholders, including the investors in this offering, to be lower than they otherwise might have been.

Restrictions on ownership of a controlling percentage of our capital stock might limit your opportunity to receive a premium on our stock.

For the purpose of preserving our REIT qualification and for other reasons, our charter prohibits direct or constructive ownership by any person of more than 9.8% of the lesser of the total number or value of the outstanding shares of our common stock or more than 9.8% of the outstanding shares of our preferred stock. The constructive ownership rules in our charter are complex and may cause the outstanding stock owned by a group of related individuals or entities to be deemed to be constructively owned by one individual or entity. As a result, the acquisition of less than 9.8% of the outstanding stock by an individual or entity could cause that individual or entity to own constructively in excess of 9.8% of the outstanding stock, and thus be subject to the ownership limit in our charter. Any attempt to own or transfer shares of our common or preferred stock in excess of the ownership limit without the consent of our board of directors shall be void, and will result in the shares being transferred by operation of law to a charitable trust. These provisions might inhibit market activity and the resulting opportunity for our stockholders to receive a premium for their shares that might otherwise exist if any person were to attempt to assemble a block of shares of our stock in excess of the number of shares permitted under our charter and which may be in the best interests of our stockholders.

Table of Contents

Certain provisions of Maryland law and our charter and bylaws could hinder, delay or prevent a change in control of our company.

Certain provisions of Maryland law, our charter and our bylaws have the effect of discouraging, delaying or preventing transactions that involve an actual or threatened change in control of our company. These provisions include the following:

Classified Board of Directors. Our board of directors is divided into three classes with staggered terms of office of three years each. The classification and staggered terms of office of our directors make it more difficult for a third party to gain control of our board of directors. At least two annual meetings of stockholders, instead of one, generally would be required to effect a change in a majority of the board of directors.

Removal of Directors. Under our charter, subject to the rights of one or more classes or series of preferred stock to elect one or more directors, a director may be removed only for cause and only by the affirmative vote of at least two-thirds of all votes entitled to be cast by our stockholders generally in the election of directors.

Number of Directors, Board Vacancies, Term of Office. Under certain amendments to our bylaws which will become effective at such time as a class of our equity securities is registered under the Securities Exchange Act of 1934, as amended, or the Exchange Act, (which will occur upon completion of our initial public offering), we have elected to be subject to certain provisions of Maryland law which vest in the board of directors the exclusive right to determine the number of directors and the exclusive right, by the affirmative vote of a majority of the remaining directors, to fill vacancies on the board even if the remaining directors do not constitute a quorum. These provisions of Maryland law, which are applicable even if other provisions of Maryland law or the charter or bylaws provide to the contrary, also provide that any director elected to fill a vacancy shall hold office for the remainder of the full term of the class of directors in which the vacancy occurred, rather than the next annual meeting of stockholders as would otherwise be the case, and until his or her successor is elected and qualifies.

Limitation on Stockholder-Requested Special Meetings. Our bylaws provide that our stockholders have the right to call a special meeting only upon the written request of stockholders entitled to cast not less than a majority of all the votes entitled to be cast by the stockholders at such meeting.

Advance Notice Provisions for Stockholder Nominations and Proposals. Our bylaws require advance written notice for stockholders to nominate persons for election as directors at, or to bring other business before, any meeting of stockholders. This bylaw provision limits the ability of stockholders to make nominations of persons for election as directors or to introduce other proposals unless we are notified in a timely manner prior to the meeting.

Exclusive Authority of our Board to Amend the Bylaws. Our bylaws provide that our board of directors has the exclusive power to adopt, alter or repeal any provision of the bylaws or to make new bylaws. Thus, our stockholders may not effect any changes to our bylaws.

Preferred Stock. Under our charter, our board of directors has authority to issue preferred stock from time to time in one or more series and to establish the terms, preferences and rights of any such series of preferred stock, all without approval of our stockholders.

Duties of Directors with Respect to Unsolicited Takeovers. Maryland law provides protection for Maryland corporations against unsolicited takeovers by limiting, among other things, the duties of the directors in unsolicited takeover situations. The duties of directors of Maryland corporations do not require them to (1) accept, recommend or respond to any proposal by a person seeking to acquire control of the corporation, (2) authorize the corporation to redeem any rights under, or modify or render inapplicable, any stockholders rights plan, (3) make a determination under the Maryland Business Combination Act or the Maryland Control Share Acquisition Act, or (4) act or fail to act solely because of the effect of the act or failure to act may have on an acquisition or potential acquisition of control of the corporation or the amount or type of consideration that may be offered or paid to the stockholders in an acquisition. Moreover, under Maryland law the act of the directors of a Maryland corporation relating to or affecting an acquisition or potential acquisition of control is not subject to any higher duty or greater scrutiny than is applied to any other act of a director. Maryland law also contains a statutory presumption that an act of a director of a Maryland corporation satisfies the applicable standards of conduct for directors under Maryland law.

Ownership Limit. In order to preserve our status as a REIT under the Internal Revenue Code, our charter generally permits any single stockholder, or any group of affiliated stockholders, from beneficially owning more than 9.8% of our outstanding common or preferred stock unless our board of directors waives or modifies this ownership limit.

Maryland Business Combination Act. The Maryland Business Combination Act provides that unless exempted, a Maryland corporation may not engage in business combinations, including mergers, dispositions of 10% or more of its assets, issuance of shares of stock and other specified transactions, with an interested stockholder or an affiliate of an interested stockholder for five years after the most recent date on which the interested stockholder became an interested stockholder, and thereafter unless specified criteria are met. An interested stockholder is generally a person owning or controlling, directly or indirectly, 10% or more of the voting power of the outstanding stock of a Maryland corporation. Our board of directors has adopted a resolution exempting our company from this statute. However, our board of directors may repeal or modify this resolution in the future, in which case the provisions of the Maryland Business Combination Act will be applicable to business combinations between our company and other persons.

Maryland Control Share Acquisition Act. Maryland law provides that control shares of a corporation acquired in a control share acquisition shall have no voting rights except to the extent approved by a vote of two-thirds of the votes eligible to be cast on the matter under the Maryland Control Share Acquisition Act. Control shares means shares of stock that, if aggregated with all other shares of stock previously acquired by the acquiror, would entitle the acquiror to exercise voting power in electing directors within one of the following ranges of the voting power: one-tenth or more but less than one-third, one-third or more but less than a majority or a majority or more of all voting power. A control share acquisition means the acquisition of control shares, subject to certain exceptions. If voting rights of control shares acquired in a control share acquisition are not approved at a stockholders meeting, then subject to certain conditions and limitations, the issuer may redeem any or all of the control shares for fair value. If voting rights of such control shares are approved at a stockholders meeting and the acquiror becomes entitled to vote a majority of the shares of stock entitled to vote, all other stockholders may exercise appraisal rights. Our bylaws contain a provision exempting acquisitions of our shares from the Maryland Control Share Acquisition Act. However, our board of directors may amend our bylaws in the future to repeal or modify this exemption, in which case any control shares of our company acquired in a control share acquisition will be subject to the Maryland Control Share Acquisition Act.

Future offerings of debt securities, which would be senior to our common stock upon liquidation, or equity securities, which would dilute our existing stockholders and may be senior to our common stock for the purposes of distributions, may harm the value of our common stock.

In the future, we may attempt to increase our capital resources by making additional offerings of debt or equity securities, including commercial paper, medium-term notes, senior or subordinated notes and classes of preferred stock or common stock. Upon the liquidation of our company, holders of our debt securities and shares of preferred stock and lenders with respect to other borrowings will receive a distribution of our available assets prior to the holders of our common stock. Additional equity offerings by us may dilute the holdings of our existing stockholders or reduce the value of our common stock, or both. Our preferred stock, if issued, would have a preference on distributions that could limit our ability to make distributions to the holders of our common stock. Because our decision to issue securities in any future offering will depend on market conditions and other factors beyond our control, we cannot predict or estimate the amount, timing or nature of our future offerings.

Table of Contents

Thus, our stockholders bear the risk of our future offerings reducing the market price of our common stock and diluting their stock holdings in us.

A regular trading market for our common stock might not develop, which would harm the liquidity and value of our common stock.

There is no established trading market for our common stock. Our common stock has been approved for listing on the New York Stock Exchange, subject to official notice of issuance, under the symbol LUM. However, we cannot assure you that regular trading of our common stock will develop on that exchange or elsewhere or, if developed, that any such market will be sustained. Accordingly, we cannot assure you of:

- the likelihood that a regular market for our common stock will develop;
- the liquidity of any such market;
- the ability of our stockholders to sell their shares of our common stock; or
- the prices that our stockholders may obtain for their shares of our common stock.

Currently, shares of our common stock trade among qualified institutional buyers (i.e., institutional investors with at least $100 million invested in securities) and are eligible for resale in accordance with Rule 144A under the Securities Act of 1933, as amended, or the Securities Act.

The market price and trading volume of our common stock may be volatile following this offering.

Even if an active trading market develops for our common stock after this offering, the market price of our common stock may be highly volatile and be subject to wide fluctuations. In addition, the trading volume in our common stock may fluctuate and cause significant price variations to occur. If the market price of our common stock declines significantly, you may be unable to resell your shares at or above the initial public offering price. We cannot assure you that the market price of our common stock will not fluctuate or decline significantly in the future. Some of the factors that could negatively affect our stock price or result in fluctuations in the price or trading volume of our common stock include:

- actual or anticipated variations in our quarterly operating results or distributions;
- changes in our funds from operations or earnings estimates or publication of research reports about us or the real estate industry, although there can be no assurance that any research reports about us will be published;
- increases in market interest rates that lead purchasers of our shares to demand a higher yield;

- changes in market valuations of similar companies;
- adverse market reaction to any increased indebtedness we incur in the future;
- additions or departures of key management personnel;
- actions by institutional stockholders;
- speculation in the press or investment community; and
- general market and economic conditions.

Broad market fluctuations could harm the market price of our common stock.

The stock market has experienced extreme price and volume fluctuations that have affected the market price of many companies in industries similar or related to ours and that have been unrelated to these companies operating performances. These broad market fluctuations could reduce the market price of our common stock. Furthermore, our operating results and prospects may be below the expectations of public market analysts and investors or may be lower than those of companies with comparable market capitalizations, which could harm the market price of our common stock.

Table of Contents

Shares of our common stock eligible for future sale may harm our share price.

We cannot predict the effect, if any, of future sales of shares of our common stock, or the availability of shares for future sales, on the market price of our common stock. Sales of substantial amounts of these shares of our common stock, or the perception that these sales could occur, may harm prevailing market prices for our common stock. As of September 30, 2003, there were:

- 11,704,000 shares of outstanding common stock;
- outstanding options to purchase 50,000 shares of our common stock at an exercise price of $15.00 per share;
- an additional 950,000 shares of our common stock reserved for future awards and grants under our stock incentive plans.

On November 3, 2003, we issued 5,000 options, at an exercise price of $13.00 per share, to our full-time controller. Immediately following this offering, there will be a total of 945,000 shares of our common stock, or 1% of our current total authorized shares, reserved for future awards and grants under our stock incentive plans. We intend to file, shortly after the effectiveness of this offering, a registration statement on Form S-8 under the Securities Act covering all shares of our common stock reserved for issuance under the stock plans and subject to outstanding options under our stock incentive plans. Shares of our common stock issued upon exercise of options under the Form S-8 will be available for sale in the public market, subject to Rule 144 volume limitations applicable to affiliates and subject to the contractual restrictions described above.

We have filed a separate registration statement with the SEC that will permit the resale of all of the shares of our common stock held by our stockholders that are not included in this offering, other than 204,000 shares purchased in April 2003, and will use commercially reasonable efforts to cause that resale registration statement to be declared effective as promptly as is reasonably practicable. The holders of the shares of our common stock covered by that resale registration statement will be contractually restricted from selling their shares covered by the resale registration statement for 60 days following the date of this prospectus, unless they obtain the prior written consent of Friedman, Billings, Ramsey & Co., Inc. or another exception applies.

If any or all of the above holders sell a large number of securities in the public market, the sale could reduce the market price of our common stock and could impede our ability to raise future capital. In addition, we anticipate filing a registration statement with respect to the shares of our common stock issuable upon exercise of options issued under our stock incentive plans following this offering. In addition, the sale of these shares could impair our ability to raise capital through a sale of additional equity securities.

Changes in yields may harm the market price of our stock.

Our earnings are derived primarily from the expected positive spread between the yield on our assets and the cost of our borrowings. This spread will not necessarily be larger in high interest rate environments than in low interest rate environments and may also be negative. In addition, during periods of high interest rates, our net income, and therefore the amount of any distributions on our common stock, might be less attractive compared to alternative investments of equal or lower risk. Each of these factors could harm the market price of our common stock.

Terrorist attacks and other acts of violence or war may affect any market for our common stock, the industry in which we operate, our operations and our profitability.

Terrorist attacks may harm our results of operations and your investment. We cannot assure you that there will not be further terrorist attacks against the United States or U.S. businesses. These attacks or armed conflicts may impact the property underlying our mortgage-backed securities directly or indirectly, by undermining economic conditions in the United States. Losses resulting from terrorist events are generally uninsurable.

Table of Contents

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This prospectus contains certain forward-looking statements. Forward looking statements are those which are not historical in nature. They can often be identified by their inclusion of words such as will, anticipate, estimate, should, expect, believe, intend and similar expressions projection of revenues, earnings or losses, capital expenditures, distributions, capital structure or other financial terms is a forward-looking statement.

Our forward-looking statements are based upon our management s beliefs, assumptions and expectations of our future operations and economic performance, taking into account the information currently available to us. Forward-looking statements involve risks and uncertainties, some of which are not currently known to us, that might cause our actual results, performance or financial condition to be materially different from the expectations of future results, performance or financial condition we express or imply in any forward-looking statements. Some of the important factors that could cause our actual results, performance or financial condition to differ materially from expectations are:

- our limited operating history and Seneca s lack of experience in managing a REIT;
- your inability to review the assets that we will acquire with the net proceeds of this offering;
- interest rate mismatches between our mortgage-backed securities and our borrowings used to fund such purchases;
- changes in interest rates and mortgage prepayment rates;
- effects of interest rate caps on our adjustable-rate mortgage-backed securities;
- the degree to which our hedging strategies may or may not protect us from interest rate volatility;
- potential impacts of our leveraging policies on our net income and cash available for distribution;
- our ability to invest up to 10% of our investment portfolio in lower-credit quality mortgage-backed securities which carry an increased likelihood of default or rating downgrade relative to investment-grade securities;
- our board s ability to change our operating policies and strategies without notice to you or stockholder approval;
- Seneca s motivation to recommend riskier investments in an effort to maximize its incentive compensation under the management agreement;
- potential conflicts of interest arising out of our relationship with Seneca, on the one hand, and Seneca s relation with other third parties, on the other hand; and

the other important factors described in this prospectus, including under the captions Risk Factors, Management s Discussion and Analysis of Financial Condition and Results of Operations, and Quantitative and Qualitative Disclosures about Market Risk.

We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. In light of these risks, uncertainties and assumptions, the events described by our forward-looking events might not occur. We qualify any and all of our forward-looking statements by these cautionary factors. Please keep this cautionary note in mind as you read this prospectus.

This prospectus contains market data, industry statistics and other data that have been obtained from, or compiled from, information made available by third parties. We have not independently verified their data.

Table of Contents

USE OF PROCEEDS

We estimate that our net proceeds that we receive in this offering will be approximately $137.0 million, based on the public offering price of $13.00 per share and after deducting the underwriting discount and estimated offering expenses of $850,000 payable by us. If the underwriters over-allotment option is exercised in full, we estimate that our net proceeds will be approximately $157.6 million.

We intend to use the net proceeds of this offering received by us to expand our portfolio of mortgage-related assets, primarily U.S. agency and other highly-rated, single-family, adjustable-rate, hybrid adjustable-rate and fixed-rate mortgage-backed securities. We expect to pay market rates for brokerage fees and commissions when purchasing the securities. Until such assets can be identified and obtained, we intend to temporarily invest the balance of the proceeds of this offering in readily marketable interest-bearing assets consistent with our intention to qualify as a REIT.

Set forth below is a tabular presentation of the expected uses of the gross proceeds of this offering, based on the public offering price of $13.00 per share. The information is presented assuming no exercise and full exercise, respectively, of the underwriters over-allotment option to purchase additional shares. All amounts in the table are estimates.

	No Exercise of Over-Allotment Option		Full Exercise of Over-Allotment Option	
	Dollars	Percent	Dollars	Percent
	(in millions)		(in millions)	
Gross offering proceeds	$ 148.2(1)	100.00%	$ 170.4(2)	100.00%
Public offering expenses				
Underwriting discount and commissions	10.3	7.00	11.9	7.00
Paid to affiliate	0.0	0.00	0.0	0.00
Organizational and offering expenses	0.9(3)	0.56	0.9(3)	0.51
Net offering proceeds	$ 137.0	92.44%	$ 157.6	92.49%
Amount of net proceeds used for acquisition of mortgage-backed securities				
Net purchases of mortgage-backed securities	$ 136.9	92.39%	$ 157.5	92.44%
Estimated commissions on purchases of mortgage-backed securities	0.1(4)	0.05	0.1(4)	0.05
Estimated commissions paid to lenders in connection with borrowings used for acquisitions	0.0	0.00	0.0	0.00
Amount of net proceeds used to pay cash component of management fees	0.0	0.00	0.0	0.00
Amount of net proceeds used for general corporate or working capital purposes	0.0	0.00	0.0	0.00
Amount of net proceeds used to pay cash distribution payable on January 28, 2004	0.0(5)	0.00	0.0(5)	0.00
Total net offering proceeds used	137.0	92.44	157.6	92.49
Public offering expenses	11.2	7.56	12.8	7.51

Total application of gross offering proceeds	$ 148.2	100.00%	$ 170.4	100.00%

(1) Assumes the sale of 11,400,000 shares by Luminent at the public offering price of $13.00 per share.
(2) Assumes the sale of 13,110,000 shares by Luminent at the public offering price of $13.00 per share.
(3) Includes the Securities and Exchange Commission registration fee of $13,788, the NASD filing fee of $17,543, accounting fees and expenses of $110,000, legal fees and expenses of $560,000, printing fees and expenses of $100,000, and miscellaneous offering expenses of $48,667.
(4) Mortgage-backed securities do not trade with commissions. For the purposes of this table, we have assumed an average commission on the purchase of mortgage-backed securities of approximately 0.05%.
(5) On November 24, 2003, our board of directors declared a cash distribution of $0.45 per share to stockholders of record on December 11, 2003, payable on January 28, 2004.

Table of Contents

MARKET PRICE OF AND DISTRIBUTIONS ON OUR COMMON STOCK

Market Information

Prior to this offering, our common stock has not been listed or quoted on any national exchange or market system. However, certain of our stockholders have privately sold shares of our common stock using the PORTAL system. The following table sets forth, for the periods indicated, the high and low sale prices for our common stock as reported on The PORTAL Market of which we are aware since June 11, 2003, the date of our private placement:

	Common Stock	
	High	Low
2003		
Second Quarter (from June 11, 2003)	$ 15.35	$ 15.00
Third Quarter	$ 15.60	$ 15.00
Fourth Quarter (through December 18, 2003)	$ 15.00	$ 13.00

As of September 30, 2003, we had 11,704,000 shares of common stock issued and outstanding which were held by 13 holders of record. The 13 holders of record include Cede & Co., which holds shares as nominee for The Depository Trust Company, which itself holds shares on behalf of over 400 beneficial owners of our common stock. Our common stock has been approved for listing on the New York Stock Exchange, subject to official notice of issuance, under the symbol LUM. While our common stock has been sold privately from time to time after the closing of the private placement, and certain of these trades have been reported on the PORTAL Market, this information is not complete since we only have access to the trades that are reported by our underwriters and not trades that are reported by any other broker-dealers. Moreover, broker-dealers are not obligated to report all trades to PORTAL.

Distribution Policy

The following table sets forth, for the periods indicated, the cash distributions declared per share of our common stock since June 11, 2003, the date of our private placement:

	Cash Distributions Declared Per Share
2003	
Second Quarter (from June 11, 2003)	$
Third Quarter	$ 0.50
Fourth Quarter	$ 0.45

Our distributions declared to date are not necessarily indicative of distributions that we will declare in the future. We expect that future distributions will be based on our REIT taxable net income in future periods, which we cannot predict with any certainty. All distribution declarations are made at the discretion of our board of directors.

On October 1, 2003, we declared a cash distribution of $0.50 per share to our stockholders of record on October 21, 2003. We paid the distribution on November 17, 2003. All of the distribution is a taxable dividend, and none of the distribution is a return of capital. The distribution was funded with cash flow from our ongoing operations, including principal payments and interest payments on our mortgage-backed securities. As of September 30, 2003, interest receivable was $5.6 million and principal receivable was $3.6 million; total principal payments received in the three months ended September 30, 2003 were $96.7 million.

On November 24, 2003, our board of directors declared a cash distribution of $0.45 per share for the fourth quarter of 2003, payable on January 28, 2004 to stockholders of record on December 11, 2003. This offering will

Table of Contents

close subsequent to the distribution record date and, accordingly, purchasers of common stock in this offering will not receive the distribution. Although we reported a net loss of $2.8 million for the three months ended September 30, 2003, and our results of operations for the three months ending December 31, 2003 cannot be definitively predicted at this time, we expect that this cash distribution will be funded with cash flow from our ongoing operations and not with any portion of the proceeds of this offering. The aggregate amount of our fourth quarter distribution payable on January 28, 2004 is $5.3 million, while our current portfolio generates a monthly cash flow significantly in excess of that payable amount. For example, for the three months ended October 31, 2003, we received from our portfolio combined coupon cash flow and principal payments in the amount of $141.9 million, for an average of $47.3 million per month. Accordingly, we expect that we will be able to fund the entire $5.3 million distribution with cash flow from our ongoing operations. To the extent that source might be insufficient, we will fund the distribution with sales of mortgage-backed securities and/or with borrowings under repurchase agreements or our line of credit.

Because our fourth quarter performance is unknown at this time, we cannot definitively predict whether the January 28, 2004 distribution will exceed our REIT taxable net income for the fourth quarter. As allowed by the tax code for a REIT s fourth quarter distribution, our January 28, 2004 distribution will be deemed to be a dividend made by us on December 31, 2003 to the extent of our 2003 undistributed earnings and profits (as determined under the tax code), even though it will be paid in 2004. Any amount of the distribution in excess of our previously undistributed 2003 earnings and profits should, for federal income tax purposes, be treated as a distribution in 2004. We refer to any such excess as the carry-over amount. In that case, our REIT-related distribution requirement for 2004 would be reduced by the carry-over amount. Any reduction to our 2004 REIT-related distribution requirement could cause our total 2004 distributions to stockholders, including the investors in this offering, to be lower than they otherwise might have been. In the event that our (tax) earnings and profits for the year 2004 are less than the carry-over amount, the carry-over amount would, to that extent, be treated for federal income tax purposes first as a tax-free return of capital in 2004 (to the extent of an investor s tax basis in our shares), and then as producing gain, rather than a dividend. Because our 2004 (tax) earnings and profits cannot be predicted at this time, we cannot determine whether any carry-over amount will be treated as a dividend, a return of capital or as producing gain for federal income tax purposes.

The aggregate amount of our fourth quarter distribution payable on January 28, 2004 is $5.3 million. This distribution declaration is irrevocable and is not contingent on our operating performance. However, if and to the extent that we do not generate sufficient cash flow from ongoing operations (including principal payments and interest payments on our mortgage-backed securities) to fund the distribution, we will need to sell mortgage-backed securities or borrow funds by entering into repurchase agreements or otherwise borrowing funds under our line of credit to pay the distribution. We generally do not intend to declare distributions before our operating results for a period are better known. However, because this offering is scheduled to close late in the quarter, our board of directors determined that it would be inequitable to our current stockholders if new investors participated in the fourth quarter distribution and, accordingly, the board declared a distribution with a record date prior to this offering s anticipated closing date.

We intend to distribute all or substantially all of our REIT taxable net income (which does not ordinarily equate to net income as calculated in accordance with GAAP) to our stockholders in each year. We intend to make regular quarterly distributions to our stockholders to be paid out of funds readily available for such distributions. Our distribution policy is subject to revision at the discretion of our board of directors without notice to you or stockholder approval. We have not established a minimum distribution level and our ability to make distributions may be harmed for the reasons described under the caption Risk Factors. All distributions will be made by us at the discretion of our board of directors and will depend on our earnings and financial condition, maintenance of REIT status, applicable provisions of the Maryland general corporation law, or MGCL, and such other factors as our board of directors deems relevant.

Table of Contents

In order to avoid corporate income and excise tax and to maintain our qualification as a REIT under the Internal Revenue Code, we must make distributions to our stockholders each year in an amount at least equal to:

90% of our REIT taxable net income;

plus 90% of the excess of net income from foreclosure property over the tax imposed on such income by the Internal Revenue Code;

minus any excess non-cash income.

In general, our distributions will be applied toward these requirements only if paid in the taxable year to which they relate, or in the following taxable year if the distributions are declared before we timely file our tax return for that year, the distributions are paid on or before the first regular distribution payment following the declaration and we elect on our tax return to have a specified dollar amount of such distributions treated as if paid in the prior year. Distributions declared by us in October, November or December of one taxable year and payable to a stockholder of record on a specific date in such a month are treated as both paid by us and received by the stockholder during such taxable year, provided that the distribution is actually paid by us by January 31 of the following taxable year.

We anticipate that distributions generally will be taxable as ordinary income to our stockholders, although a portion of such distributions may be designated by us as capital gain or may constitute a return of capital. We will furnish annually to each of our stockholders a statement setting forth distributions paid during the preceding year and their characterization as ordinary income, return of capital or capital gains.

We will seek to borrow between eight and 12 times the amount of our equity, and as of September 30, 2003 we had established 17 borrowing agreements with various investment banking firms and other lenders, nine of which were in use on September 30, 2003. Under the terms of such borrowing agreements, our lenders may impose restrictions upon the timing and amount of our distributions to our stockholders.

In the future, our board of directors may elect to adopt a dividend reinvestment plan.

Table of Contents

CAPITALIZATION

The following table sets forth our capitalization as of September 30, 2003:

on an actual basis (as restated, see Note 10 to the financial statements);

on a pro forma basis to give effect to our cash distribution of $5.9 million declared on October 1, 2003, which was paid on November 17, 2003, and our cash distribution of $5.3 million declared on November 24, 2003, which is payable on January 28, 2003 to stockholders of record on December 11, 2003 (as restated, see Note 10 to the financial statements); and

on an as adjusted basis to give effect to the above pro forma adjustments and to our sale of 11,400,000 shares of our common stock in this offering, at the public offering price of $13.00 per share and after deducting the underwriters discounts and commissions and estimated offering expenses payable by us.

	At and as of September 30, 2003		
	Actual (as restated)	Pro forma	Pro forma (as restated) as adjusted
	(in thousands, except share and per share amounts) (unaudited)		
Stockholders equity:			
Preferred stock, par value $0.001: 10,000,000 shares authorized; no shares issued and outstanding actual, pro forma or pro forma as adjusted			
Common stock, par value $0.001: 100,000,000 shares authorized; 11,704,000 shares issued and outstanding actual and pro forma; 23,104,000 shares issued and outstanding pro forma as adjusted	$ 11.7	$ 11.7	$ 23.1
Additional paid in capital	160,330.1	160,330.1	297,294.7
Accumulated other comprehensive loss	(18,248.2)	(18,248.2)	(18,248.2)
Accumulated deficit	(2,642.6)	(13,761.4)	(13,761.4)
Total stockholders equity	$ 139,451.0	$ 128,332.2	$ 265,308.2

The table above excludes the following shares:

a total of 950,000 shares of our common stock available for awards under our two stock incentive plans as of September 30, 2003;

a total of 50,000 shares of our common stock issuable upon exercise of options outstanding as of September 30, 2003 at an exercise price of $15.00;

- a currently indeterminate number of shares of our common stock that might become issuable in connection with Seneca s incentive compensation under the management agreement; and

- a currently indeterminate number of shares of our common stock that might become issuable in connection with the incentive bonus under Mr. Zyda s employment agreement.

Subsequent to the date as of which information is presented in the table above:

- we issued 5,000 options at an exercise price of $13.00 per share to our full-time controller on November 3, 2003; and

- we granted an option to the underwriters of this offering to purchase up to 1,710,000 shares of our common stock from us, solely to cover over-allotments.

Table of Contents

DILUTION

Our net tangible book value as of September 30, 2003 was approximately $139.5 million, or $11.91 per share of our common stock. If you invest in our common stock, your interest will be diluted to the extent of the difference between the price you pay per share of our common stock and the net tangible book value per share of our common stock at the time of your purchase. Net tangible book value per share is calculated by subtracting our total liabilities from our total tangible assets, which is total assets less intangible assets, and dividing this amount by the number of shares of our common stock issued and outstanding. After giving effect to the sale by us of 11,400,000 shares of our common stock in this offering, at the public offering price of $13.00 per share, and after deducting the underwriters discounts and commissions and estimated offering expenses payable by us, our net tangible book value as of September 30, 2003 would have been $276.4 million, or $11.96 per share of our common stock. This represents an immediate increase in the net tangible book value of $0.05 per share to our existing stockholders and an immediate and substantial dilution in net tangible book value of $1.04 per share to new investors. The following table illustrates this per share dilution:

Public offering price per share		$ 13.00
Net tangible book value per share as of September 30, 2003	$ 11.91	
Increase per share attributable to new investors	0.05	
Net tangible book value per share after this offering		11.96
Dilution per share to new investors		$ 1.04

The following table summarizes the total number of shares of our common stock purchased from us, the total consideration paid to us (gross proceeds) and the average price per share paid by existing stockholders and by new investors, in each case based upon the number of shares of our common stock outstanding as of September 30, 2003 and the initial public offering price of $13.00 per share.

	Shares Purchased		Total Consideration		Average Price
	Number	Percent	Amount	Percent	Per Share