

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2006

or

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

For the transition period from _____ to _____

Commission File Number: 001-31458

Newcastle Investment Corp.

(Exact name of registrant as specified in its charter)

Maryland
(State or other jurisdiction of incorporation
or organization)

81-0559116
(I.R.S. Employer Identification No.)

1345 Avenue of the Americas, New York, NY
(Address of principal executive offices)

10105
(Zip Code)

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

(Former name, former address and former fiscal year, if changed since last report)

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

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

Large accelerated filer Accelerated filer Non-accelerated filer

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the last practicable date.

Common stock, \$0.01 par value per share: 45,699,817 shares outstanding as of November 7, 2006.

NEWCASTLE INVESTMENT CORP.
FORM 10-Q

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

NEWCASTLE INVESTMENT CORP. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(dollars in thousands, except share data)

	<u>September 30,</u> <u>2006(Unaudited)</u>	<u>December 31, 2005</u>
Assets		
Real estate securities, available for sale	\$ 5,369,641	\$ 4,554,519
Real estate related loans, net	1,238,418	615,551
Residential mortgage loans, net	863,788	600,682
Subprime mortgage loans subject to future repurchase - Note 5	287,546	-
Investments in unconsolidated subsidiaries	28,549	29,953
Operating real estate, net	30,271	16,673
Cash and cash equivalents	16,317	21,275
Restricted cash	183,334	268,910
Derivative assets	64,218	63,834
Receivables and other assets	43,999	38,302
	<u>\$ 8,126,081</u>	<u>\$ 6,209,699</u>
Liabilities and Stockholders' Equity		
Liabilities		
CBO bonds payable	\$ 3,505,906	\$ 3,530,384
Other bonds payable	704,785	353,330
Notes payable	153,957	260,441
Repurchase agreements	2,197,780	1,048,203
Financing of subprime mortgage loans subject to future repurchase - Note 5	287,546	-
Credit facility	125,000	20,000
Junior subordinated notes payable (security for trust preferred)	100,100	-
Derivative liabilities	26,576	18,392
Dividends payable	30,152	29,052
Due to affiliates	9,938	8,783
Accrued expenses and other liabilities	27,175	23,111
	<u>7,168,915</u>	<u>5,291,696</u>
Stockholders' Equity		
Preferred stock, \$0.01 par value, 100,000,000 shares authorized, 2,500,000 shares of 9.75% Series B Cumulative Redeemable Preferred Stock and 1,600,000 shares of 8.05% Series C Cumulative Redeemable Preferred Stock, liquidation preference \$25.00 per share, issued and outstanding	102,500	102,500
Common stock, \$0.01 par value, 500,000,000 shares authorized, 43,999,817 and 43,913,409 shares issued and outstanding at September 30, 2006 and December 31, 2005, respectively	440	439
Additional paid-in capital	784,234	782,735
Dividends in excess of earnings	(10,923)	(13,235)
Accumulated other comprehensive income	80,915	45,564
	<u>957,166</u>	<u>918,003</u>
	<u>\$ 8,126,081</u>	<u>\$ 6,209,699</u>

NEWCASTLE INVESTMENT CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME (Unaudited)

(dollars in thousands, except share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Revenues				
Interest income	\$ 140,330	\$ 88,021	\$ 378,446	\$ 254,035
Rental and escalation income	834	1,871	3,616	4,850
Gain on sale of investments, net	2,642	6,750	10,064	12,099
Other income, net	288	3,208	4,545	4,594
	<u>144,094</u>	<u>99,850</u>	<u>396,671</u>	<u>275,578</u>
Expenses				
Interest expense	100,239	58,681	265,113	163,238
Property operating expense	1,041	594	2,808	1,827
Loan and security servicing expense	1,553	1,483	4,961	4,646
Provision for credit losses	2,682	4,091	5,868	5,990
Provision for losses, loans held for sale - Note 5	-	-	4,127	-
General and administrative expense	1,187	1,034	3,979	3,251
Management fee to affiliate	3,475	3,316	10,420	9,895
Incentive compensation to affiliate	3,094	2,416	8,780	5,271
Depreciation and amortization	290	182	767	453
	<u>113,561</u>	<u>71,797</u>	<u>306,823</u>	<u>194,571</u>
Income before equity in earnings of unconsolidated subsidiaries	30,533	28,053	89,848	81,007
Equity in earnings of unconsolidated subsidiaries	1,506	1,104	3,916	4,628
Income taxes on related taxable subsidiaries	-	(43)	-	(321)
Income from continuing operations	32,039	29,114	93,764	85,314
Income from discontinued operations	(12)	86	212	2,051
Net Income	<u>32,027</u>	<u>29,200</u>	<u>93,976</u>	<u>87,365</u>
Preferred dividends	(2,328)	(1,523)	(6,985)	(4,570)
Income Available For Common Stockholders	<u>\$ 29,699</u>	<u>\$ 27,677</u>	<u>\$ 86,991</u>	<u>\$ 82,795</u>
Net Income Per Share of Common Stock				
Basic	<u>\$ 0.68</u>	<u>\$ 0.63</u>	<u>\$ 1.98</u>	<u>\$ 1.90</u>
Diluted	<u>\$ 0.67</u>	<u>\$ 0.63</u>	<u>\$ 1.97</u>	<u>\$ 1.88</u>
Income from continuing operations per share of common stock, after preferred dividends				
Basic	<u>\$ 0.68</u>	<u>\$ 0.63</u>	<u>\$ 1.97</u>	<u>\$ 1.85</u>
Diluted	<u>\$ 0.67</u>	<u>\$ 0.63</u>	<u>\$ 1.97</u>	<u>\$ 1.84</u>
Income from discontinued operations per share of common stock				
Basic	<u>\$ (0.00)</u>	<u>\$ 0.00</u>	<u>\$ 0.01</u>	<u>\$ 0.05</u>
Diluted	<u>\$ (0.00)</u>	<u>\$ 0.00</u>	<u>\$ 0.00</u>	<u>\$ 0.04</u>
Weighted Average Number of Shares of Common Stock Outstanding				
Basic	<u>43,999,817</u>	<u>43,789,819</u>	<u>43,978,625</u>	<u>43,595,411</u>
Diluted	<u>44,136,956</u>	<u>44,121,263</u>	<u>44,091,003</u>	<u>43,961,044</u>
Dividends Declared per Share of Common Stock	<u>\$ 0.650</u>	<u>\$ 0.625</u>	<u>\$ 1.925</u>	<u>\$ 1.875</u>

NEWCASTLE INVESTMENT CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (Unaudited)
 FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2006 AND 2005
 (dollars in thousands)

	Preferred Stock		Common Stock		Additional Paid-in Capital	Dividends in Excess of Earnings	Accum. Other Comp. Income	Total Stock- holders' Equity
	Shares	Amount	Shares	Amount				
Stockholders' equity - December 31, 2005	4,100,000	\$ 102,500	43,913,409	\$ 439	\$ 782,735	\$ (13,235)	\$ 45,564	\$ 918,003
Dividends declared	-	-	-	-	-	(91,664)	-	(91,664)
Exercise of common stock options	-	-	84,000	1	1,439	-	-	1,440
Issuance of common stock to directors	-	-	2,408	-	60	-	-	60
Comprehensive income:								
Net income	-	-	-	-	-	93,976	-	93,976
Net unrealized (loss) on securities	-	-	-	-	-	-	31,775	31,775
Reclassification of net realized (gain) on securities into earnings	-	-	-	-	-	-	(637)	(637)
Foreign currency translation	-	-	-	-	-	-	763	763
Net unrealized gain on derivatives designated as cash flow hedges	-	-	-	-	-	-	6,801	6,801
Reclassification of net realized (gain) on derivatives designated as cash flow hedges into earnings	-	-	-	-	-	-	(3,351)	(3,351)
Total comprehensive income								129,327
Stockholders' equity - September 30, 2006	4,100,000	\$ 102,500	43,999,817	\$ 440	\$ 784,234	\$ (10,923)	\$ 80,915	\$ 957,166
Stockholders' equity - December 31, 2004	2,500,000	\$ 62,500	39,859,481	\$ 399	\$ 676,015	\$ (13,969)	\$ 71,770	\$ 796,715
Dividends declared	-	-	-	-	-	(86,661)	-	(86,661)
Issuance of common stock	-	-	3,300,000	33	96,518	-	-	96,551
Exercise of common stock options	-	-	628,330	6	9,491	-	-	9,497
Issuance of common stock to directors	-	-	2,008	-	67	-	-	67
Comprehensive income:								
Net income	-	-	-	-	-	87,365	-	87,365
Net unrealized (loss) on securities	-	-	-	-	-	-	(41,202)	(41,202)
Reclassification of net realized (gain) on securities into earnings	-	-	-	-	-	-	(7,157)	(7,157)
Foreign currency translation	-	-	-	-	-	-	(1,103)	(1,103)
Reclassification of net realized foreign currency translation into earnings	-	-	-	-	-	-	(626)	(626)
Net unrealized gain on derivatives designated as cash flow hedges	-	-	-	-	-	-	38,701	38,701
Reclassification of net realized loss on derivatives designated as cash flow hedges into earnings	-	-	-	-	-	-	1,657	1,657
Total comprehensive income								77,635
Stockholders' equity - September 30, 2005	2,500,000	\$ 62,500	43,789,819	\$ 438	\$ 782,091	\$ (13,265)	\$ 62,040	\$ 893,804

NEWCASTLE INVESTMENT CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOW (Unaudited)

(dollars in thousands)

	<u>Nine Months Ended September 30,</u>	
	<u>2006</u>	<u>2005</u>
Cash Flows From Operating Activities		
Net income	\$ 93,976	\$ 87,365
Adjustments to reconcile net income to net cash provided by (used in) operating activities (inclusive of amounts related to discontinued operations):		
Depreciation and amortization	767	629
Accretion of discount and other amortization	(14,976)	174
Equity in earnings of unconsolidated subsidiaries	(3,916)	(4,628)
Distributions of earnings from unconsolidated subsidiaries	3,916	4,049
Deferred rent	(1,274)	(1,776)
Gain on sale of investments	(10,430)	(13,893)
Unrealized gain on non-hedge derivatives and hedge ineffectiveness	(4,421)	(6,559)
Provision for credit losses	5,868	5,990
Provision for losses, loans held for sale	4,127	-
Purchase of loans held for sale - Note 5	(1,511,086)	-
Sale of loans held for sale - Note 5	1,507,588	-
Non-cash directors' compensation	60	67
Change in:		
Restricted cash	34,398	(117,679)
Receivables and other assets	(524)	(1,016)
Due to affiliates	1,155	(2,583)
Accrued expenses and other liabilities	8,757	61,993
Net cash provided by operating activities	<u>113,985</u>	<u>12,133</u>
Cash Flows From Investing Activities		
Purchase of real estate securities	(1,116,676)	(815,728)
Proceeds from sale of real estate securities	306,618	50,082
Deposit on real estate securities (treated as a derivative)	-	(32,439)
Purchase of and advances on loans	(1,267,511)	(609,567)
Proceeds from settlement of loans	-	1,024
Repayments of loan and security principal	417,277	540,749
Margin deposits on derivative instruments	(33,387)	-
Return of margin deposits on derivative instruments	30,349	-
Margin deposits on total rate of return swaps (treated as derivative instruments)	(46,158)	(39,099)
Return of margin deposits on total rate of return swaps (treated as derivative instruments)	89,255	-
Proceeds from termination of derivative instruments	17,982	762
Proceeds from sale of derivative instrument into Securitization Trust - Note 5	5,623	-
Payments on settlement of derivative instruments	-	(1,112)
Purchase and improvement of operating real estate	(1,314)	(188)
Proceeds from sale of operating real estate	-	52,333
Contributions to unconsolidated subsidiaries	(100)	-
Distributions of capital from unconsolidated subsidiaries	1,504	9,122
Payment of deferred transaction costs	-	(38)
Net cash used in investing activities	<u>(1,596,538)</u>	<u>(844,099)</u>

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NEWCASTLE INVESTMENT CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOW (Unaudited)

(dollars in thousands)

	<u>Nine Months Ended September 30,</u>	
	<u>2006</u>	<u>2005</u>
Cash Flows From Financing Activities		
Issuance of CBO bonds payable	-	442,034
Repayments of CBO bonds payable	(27,716)	(7,364)
Issuance of other bonds payable	631,988	246,547
Repayments of other bonds payable	(276,082)	(98,786)
Repayments of notes payable	(106,484)	(327,080)
Borrowings under repurchase agreements	3,300,477	675,500
Repayments of repurchase agreements	(2,150,900)	(182,547)
Draws under credit facility	393,900	42,000
Repayments of credit facility	(288,900)	-
Issuance of junior subordinated notes payable	100,100	-
Issuance of common stock	-	97,680
Costs related to issuance of common stock	-	(1,129)
Exercise of common stock options	1,440	9,497
Dividends paid	(90,564)	(84,205)
Payment of deferred financing costs	(9,664)	(1,683)
Net cash provided by financing activities	<u>1,477,595</u>	<u>810,464</u>
Net Increase (Decrease) in Cash and Cash Equivalents	(4,958)	822,559
Cash and Cash Equivalents, Beginning of Period	<u>21,275</u>	<u>37,911</u>
Cash and Cash Equivalents, End of Period	<u>\$ 16,317</u>	<u>\$ 860,470</u>
Supplemental Disclosure of Cash Flow Information		
Cash paid during the period for interest expense	\$ 248,594	\$ 153,122
Cash paid during the period for income taxes	\$ 244	\$ 443
Supplemental Schedule of Non-Cash Investing and Financing Activities		
Common stock dividends declared but not paid	\$ 28,600	\$ 27,369
Preferred stock dividends declared but not paid	\$ 1,552	\$ 1,016
Deposits used in acquisition of real estate securities (treated as derivatives)	\$ -	\$ 44,504
Foreclosure of loans	\$ 12,200	\$ -
Acquisition and financing of loans subject to future repurchase	\$ 286,315	\$ -

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

SEPTEMBER 30, 2006

(dollars in tables in thousands, except share data)

1. GENERAL

Newcastle Investment Corp. (and its subsidiaries, "Newcastle") is a Maryland corporation that was formed in 2002. Newcastle conducts its business through three primary segments: (i) real estate securities and real estate related loans, (ii) residential mortgage loans, and (iii) operating real estate.

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

Newcastle is party to a management agreement (the "Management Agreement") with Fortress Investment Group LLC (the "Manager"), an affiliate, under which the Manager advises Newcastle on various aspects of its business and manages its day-to-day operations, subject to the supervision of Newcastle's board of directors. For its services, the Manager receives an annual management fee and incentive compensation, both as defined in the Management Agreement.

Approximately 2.9 million shares of Newcastle's common stock were held by an affiliate of the Manager and its principals at September 30, 2006. In addition, an affiliate of the Manager held options to purchase approximately 1.2 million shares of Newcastle's common stock at September 30, 2006.

The accompanying consolidated financial statements and related notes of Newcastle have been prepared in accordance with accounting principles generally accepted in the United States for interim financial reporting and the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, certain information and footnote disclosures normally included in financial statements prepared under U.S. generally accepted accounting principles have been condensed or omitted. In the opinion of management, all adjustments considered necessary for a fair presentation of Newcastle's financial position, results of operations and cash flows have been included and are of a normal and recurring nature. The operating results presented for interim periods are not necessarily indicative of the results that may be expected for any other interim period or for the entire year. These financial statements should be read in conjunction with Newcastle's consolidated financial statements for the year ended December 31, 2005 and notes thereto included in Newcastle's annual report on Form 10-K filed with the Securities and Exchange Commission. Capitalized terms used herein, and not otherwise defined, are defined in Newcastle's consolidated financial statements for the year ended December 31, 2005.

NEWCASTLE INVESTMENT CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

SEPTEMBER 30, 2006

(dollars in tables in thousands, except share data)

2. INFORMATION REGARDING BUSINESS SEGMENTS

Newcastle conducts its business through three primary segments: real estate securities and real estate related loans, residential mortgage loans, and operating real estate.

The residential mortgage loans segment includes the securitized retained equity and bonds from the Securitization Trust described in Note 5 since they represent a first loss credit position in residential loans.

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

	Real Estate Securities and Real Estate Related Loans	Residential Mortgage Loans	Operating Real Estate	Unallocated	Total
<u>September 30, 2006 and the Nine Months then Ended</u>					
Gross revenues	\$ 317,138	\$ 75,878	\$ 3,851	\$ (196)	\$ 396,671
Operating expenses	(2,026)	(13,274)	(3,006)	(22,637)	(40,943)
Operating income (loss)	315,112	62,604	845	(22,833)	355,728
Interest expense	(210,793)	(46,696)	-	(7,624)	(265,113)
Depreciation and amortization	-	-	(562)	(205)	(767)
Equity in earnings of unconsolidated subsidiaries (A)	1,975	-	1,940	1	3,916
Income (loss) from continuing operations	106,294	15,908	2,223	(30,661)	93,764
Income from discontinued operations	-	-	212	-	212
Net Income (loss)	\$ 106,294	\$ 15,908	\$ 2,435	\$ (30,661)	\$ 93,976
Revenue derived from non-U.S. sources:					
Canada	\$ -	\$ -	\$ 2,933	\$ -	\$ 2,933
Total assets	\$ 6,820,667	\$ 1,238,856	\$ 46,255	\$ 20,303	\$ 8,126,081
Long-lived assets outside the U.S.:					
Canada	\$ -	\$ -	\$ 17,153	\$ -	\$ 17,153
<u>December 31, 2005</u>					
Total assets	\$ 5,544,818	\$ 606,320	\$ 36,306	\$ 22,255	\$ 6,209,699
Long-lived assets outside the U.S.:					
Canada	\$ -	\$ -	\$ 16,673	\$ -	\$ 16,673
<u>Three Months Ended September 30, 2006</u>					
Gross revenues	\$ 116,680	\$ 26,466	\$ 834	\$ 114	\$ 144,094
Operating expenses	(731)	(3,608)	(1,088)	(7,605)	(13,032)
Operating income (loss)	115,949	22,858	(254)	(7,491)	131,062
Interest expense	(78,696)	(17,777)	-	(3,766)	(100,239)
Depreciation and amortization	-	-	(221)	(69)	(290)
Equity in earnings of unconsolidated subsidiaries (A)	629	-	877	-	1,506
Income (loss) from continuing operations	37,882	5,081	402	(11,326)	32,039
Income from discontinued operations	-	-	(12)	-	(12)
Net Income (loss)	\$ 37,882	\$ 5,081	\$ 390	\$ (11,326)	\$ 32,027
Revenue derived from non-U.S. sources:					
Canada	\$ -	\$ -	\$ 295	\$ -	\$ 295
<u>Nine Months Ended September 30, 2005</u>					
Gross revenues	\$ 232,803	\$ 37,270	\$ 4,892	\$ 613	\$ 275,578
Operating expenses	(3,236)	(7,472)	(1,878)	(18,294)	(30,880)
Operating income (loss)	229,567	29,798	3,014	(17,681)	244,698
Interest expense	(140,240)	(22,646)	(249)	(103)	(163,238)
Depreciation and amortization	-	-	(350)	(103)	(453)
Equity in earnings of unconsolidated subsidiaries (A)	2,567	-	1,740	-	4,307
Income (loss) from continuing operations	91,894	7,152	4,155	(17,887)	85,314
Income (loss) from discontinued operations	-	-	2,051	-	2,051
Net Income (Loss)	\$ 91,894	\$ 7,152	\$ 6,206	\$ (17,887)	\$ 87,365
Revenue derived from non-U.S. sources:					
Canada	\$ -	\$ -	\$ 10,269	\$ -	\$ 10,269

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NEWCASTLE INVESTMENT CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

SEPTEMBER 30, 2006

(dollars in tables in thousands, except share data)

	Real Estate Securities and Real Estate Related Loans	Residential Mortgage Loans	Operating Real Estate	Unallocated	Total
Three Months Ended September 30, 2005					
Gross revenues	\$ 85,742	\$ 11,932	\$ 1,889	\$ 287	\$ 99,850
Operating expenses	(2,460)	(3,144)	(618)	(6,712)	(12,934)
Operating income (loss)	83,282	8,788	1,271	(6,425)	86,916
Interest expense	(50,992)	(7,588)	2	(103)	(58,681)
Depreciation and amortization	-	-	(119)	(63)	(182)
Equity in earnings of unconsolidated subsidiaries (A)	724	-	337	-	1,061
Income (loss) from continuing operations	33,014	1,200	1,491	(6,591)	29,114
Income (loss) from discontinued operations	-	-	86	-	86
Net Income (Loss)	\$ 33,014	\$ 1,200	\$ 1,577	\$ (6,591)	\$ 29,200
Revenue derived from non-U.S. sources:					
Canada	\$ -	\$ -	\$ 1,917	\$ -	\$ 1,917

(A) Net of income taxes on related taxable subsidiaries.

Unconsolidated Subsidiaries

The following table summarizes the activity affecting the equity held by Newcastle in unconsolidated subsidiaries:

	Operating Real Estate Subsidiary	Real Estate Loan Subsidiary	Trust Preferred Subsidiary
Balance at December 31, 2005	\$ 12,151	\$ 17,802	\$ -
Contributions to unconsolidated subsidiaries	-	-	100
Distributions from unconsolidated subsidiaries	(1,734)	(3,686)	-
Equity in earnings of unconsolidated subsidiaries	1,940	1,975	1
Balance at September 30, 2006	\$ 12,357	\$ 16,091	\$ 101

Summarized financial information related to Newcastle's unconsolidated subsidiaries was as follows:

	Operating Real Estate Subsidiary (A) (B)		Real Estate Loan Subsidiary (A) (C)	
	September 30, 2006	December 31, 2005	September 30, 2006	December 31, 2005
Assets	\$ 78,177	\$ 77,758	\$ 32,365	\$ 35,806
Liabilities	(53,000)	(53,000)	-	-
Minority interest	(463)	(455)	(183)	(202)
Equity	\$ 24,714	\$ 24,303	\$ 32,182	\$ 35,604
Equity held by Newcastle	\$ 12,357	\$ 12,151	\$ 16,091	\$ 17,802

	Nine Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Revenues	\$ 6,493	\$ 8,287	\$ 3,996	\$ 5,195
Expenses	(2,541)	(4,088)	(25)	(32)
Minority interest	(72)	(77)	(22)	(29)
Net income	\$ 3,880	\$ 4,122	\$ 3,949	\$ 5,134
Newcastle's equity in net income	\$ 1,940	\$ 2,061	\$ 1,975	\$ 2,567

(A) The unconsolidated subsidiaries' summary financial information is presented on a fair value basis, consistent with their internal basis of accounting.

(B) Included in the operating real estate segment.

(C) Included in the real estate securities and real estate related loans segment.

For information regarding the trust preferred subsidiary, which is a financing subsidiary with no material net income or cash flow, see Note 6.

NEWCASTLE INVESTMENT CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

SEPTEMBER 30, 2006

(dollars in tables in thousands, except share data)

3. REAL ESTATE SECURITIES

The following is a summary of Newcastle's real estate securities at September 30, 2006, all of which are classified as available for sale and are therefore marked to market through other comprehensive income.

Asset Type	Current Face Amount	Amortized Cost Basis	Gross Unrealized		Carrying Value	Number of Securities	Weighted Average			
			Gains	Losses			S&P Equivalent Rating	Coupon	Yield	Maturity (Years)
CMBS-Conduit	\$ 1,478,808	\$ 1,427,860	\$ 37,634	\$ (11,373)	\$ 1,454,121	200	BBB-	5.95%	6.50%	7.22
CMBS- CDO	23,500	20,690	1,312	(38)	21,964	2	BB	9.47%	11.86%	8.74
CMBS-Large Loan	618,014	615,712	8,212	(305)	623,619	54	BBB-	6.94%	7.11%	2.32
CMBS- B-Note	245,567	233,080	6,035	(285)	238,830	29	BB-	6.97%	7.72%	6.92
Unsecured REIT Debt	979,598	994,447	16,656	(11,612)	999,491	100	BBB-	6.37%	6.00%	6.33
ABS-Manufactured Housing	91,839	86,526	1,644	(920)	87,250	10	BB+	6.87%	7.74%	6.60
ABS-Home Equity	697,486	683,286	6,803	(902)	689,187	121	BBB	7.09%	7.55%	2.86
ABS-Franchise	79,096	78,513	1,561	(1,016)	79,058	23	BBB	7.26%	8.21%	4.93
Agency RMBS	1,091,022	1,097,009	2,511	(7,792)	1,091,728	32	AAA	5.19%	5.18%	4.33
Subtotal/Average (A)	5,304,930	5,237,123	82,368	(34,243)	5,285,248	571	BBB+	6.23%	6.46%	5.27
Retained securities (B)	37,555	34,119	233	(102)	34,250	3	BBB-	7.71%	11.01%	3.48
Residual interest (B)	50,143	50,143	-	-	50,143	1	NR	0.00%	18.77%	2.78
Total/Average	\$ 5,392,628	\$ 5,321,385	\$ 82,601	\$ (34,345)	\$ 5,369,641	575	BBB+	6.19%	6.60%	5.23

(A) The total current face amount of fixed rate securities was \$4.2 billion, and of floating rate securities was \$1.2 billion.

(B) Represents the retained bonds and equity from the Securitization Trust as described in Note 5. These securities have been treated as part of the residential mortgage loan segment - see Note 2. The residual does not have a stated coupon and therefore its coupon has been treated as zero for purposes of the table.

Unrealized losses that are considered other than temporary are recognized currently in income. There were no such losses incurred during the nine months ended September 30, 2006. The unrealized losses on Newcastle's securities are primarily the result of market factors, rather than credit impairment, and Newcastle believes their carrying values are fully recoverable over their expected holding period. None of the securities had principal in default as of September 30, 2006. Newcastle has performed credit analyses in relation to such securities which support its belief that the carrying values of such securities are fully recoverable over their expected holding period. Although management expects to hold these securities until their recovery, there is no assurance that such securities will not be sold or at what price they may be sold.

Securities in an Unrealized Loss Position	Current Face Amount	Amortized Cost Basis	Gross Unrealized		Carrying Value	Number of Securities	Weighted Average			
			Gains	Losses			S&P Equivalent Rating	Coupon	Yield	Maturity (Years)
Less Than Twelve Months	\$ 603,483	\$ 589,011	\$ -	\$ (2,589)	\$ 586,422	82	BBB-	7.80%	8.32%	4.37
Twelve or More Months	1,492,869	1,514,167	-	(31,756)	1,482,411	178	A-	5.62%	5.30%	5.61
Total	\$ 2,096,352	\$ 2,103,178	\$ -	\$ (34,345)	\$ 2,068,833	260	BBB+	6.25%	6.15%	5.25

As of September 30, 2006, Newcastle had \$139.1 million of restricted cash held in CBO financing structures pending its investment in real estate securities and loans. As of November 7, 2006, Newcastle had approximately \$100.0 million of restricted cash held in CBO financing structures pending its investment in real estate securities and loans.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

SEPTEMBER 30, 2006

(dollars in tables in thousands, except share data)

4. REAL ESTATE RELATED LOANS, RESIDENTIAL MORTGAGE LOANS AND SUBPRIME MORTGAGE LOANS

The following is a summary of real estate related loans, residential mortgage loans and subprime mortgage loans at September 30, 2006. The loans contain various terms, including fixed and floating rates, self-amortizing and interest only. They are generally subject to prepayment.

Loan Type	Current Face Amount	Carrying Value	Loan Count	Wtd. Avg. Yield	Weighted Average Maturity (Years) (D)	Delinquent Carrying Amount (E)
B-Notes	\$ 95,859	\$ 95,124	5	7.25%	4.31	\$ -
Mezzanine Loans (A)	729,701	729,509	15	8.90%	2.73	-
Bank Loans	209,691	209,813	5	7.80%	4.25	-
Whole Loans (A)	74,993	75,238	2	11.94%	1.90	-
ICH Loans (B)	130,287	128,734	74	8.64%	1.24	6,040
Total Real Estate Related Loans	<u>\$ 1,240,531</u>	<u>\$ 1,238,418</u>	<u>101</u>	<u>8.74%</u>	<u>2.90</u>	<u>\$ 6,040</u>
Residential Loans	\$ 195,159	\$ 199,952	566	6.42%	2.79	\$ 3,104
Manufactured Housing Loans	673,956	663,836	19,148	8.46%	6.05	12,928
Total Residential Mortgage Loans	<u>\$ 869,115</u>	<u>\$ 863,788</u>	<u>19,714</u>	<u>7.99%</u>	<u>5.32</u>	<u>\$ 16,032</u>
Subprime Mortgage Loans Subject to Future Repurchase (C)	<u>\$ 299,176</u>	<u>\$ 287,546</u>				

(A) Two of these loans have contractual exit fees. Newcastle has begun accruing the exit fee on one loan and will begin to accrue for the other if and when management believes it is probable that such exit fee will be received.

(B) In October 2003, pursuant to FIN No. 46, Newcastle consolidated an entity which holds a portfolio of commercial mortgage loans which has been securitized. This investment, which is referred to as the ICH CMO, was previously treated as a non-consolidated residual interest in such securitization. The primary effect of the consolidation is the requirement that Newcastle reflect the gross loan assets and gross bonds payable of this entity in its financial statements.

(C) See Note 5.

(D) The weighted average maturities for the residential loan portfolio and the manufactured housing loan portfolio were calculated based on constant prepayment rates (CPR) of approximately 30% and 9%, respectively.

(E) This face amount of loans is 60 or more days delinquent.

The following is a reconciliation of loss allowance.

	Real Estate Related Loans	Residential Mortgage Loans
Balance at December 31, 2005	\$ 4,226	\$ 3,207
Provision for credit losses	605	5,263
Realized losses	(2,931)	(2,821)
Balance at September 30, 2006	<u>\$ 1,900</u>	<u>\$ 5,649</u>

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Newcastle has entered into total rate of return swaps with a major investment bank to finance certain loans whereby Newcastle receives the sum of all interest, fees and any positive change in value amounts (the total return cash flows) from a reference asset with a specified notional amount, and pays interest on such notional plus any negative change in value amounts from such asset. These agreements are recorded in Derivative Assets and treated as non-hedge derivatives for accounting purposes and are therefore marked to market through income. Net interest received is recorded to Interest Income and the mark to market is recorded to Other Income. If Newcastle owned the reference assets directly, they would not be marked to market through income. Under the agreements, Newcastle is required to post an initial margin deposit to an interest bearing account and additional margin may be payable in the event of a decline in value of the reference asset. Any margin on deposit (recorded in Restricted Cash), less any negative change in value amounts, will be returned to Newcastle upon termination of the contract.

As of September 30, 2006, Newcastle held an aggregate of \$186.9 million notional amount of total rate of return swaps on 5 reference assets on which it had deposited \$29.2 million of margin. These total rate of return swaps had an aggregate fair value of approximately \$0.7 million, a weighted average receive interest rate of LIBOR + 2.54%, a weighted average pay interest rate of LIBOR + 0.53%, and a weighted average maturity of 1.3 years.

5. SECURITIZATION OF SUBPRIME MORTGAGE LOANS

In March 2006, Newcastle, through a consolidated subsidiary, acquired a portfolio of approximately 11,300 residential mortgage loans to subprime borrowers (the "Subprime Portfolio") for \$1.50 billion. The loans are being serviced by Centex Home Equity Company, LLC for a servicing fee equal to 0.50% per annum on the unpaid principal balance of the Subprime Portfolio. At March 31, 2006, these loans were considered "held for sale" and carried at the lower of cost or fair value. A write down of \$4.1 million was recorded to Provision for Losses, Loans Held for Sale in March 2006 related to these loans, related to market factors. Furthermore, the acquisition of loans held for sale is considered an operating activity for statement of cash flow purposes. An offsetting cash inflow from the sale of such loans (as described below) was recorded as an operating cash flow in April 2006. This acquisition was initially funded with an approximately \$1.47 billion repurchase agreement which bore interest at LIBOR + 0.50%. Newcastle entered into an interest rate swap in order to hedge its exposure to the risk of changes in market interest rates with respect to the financing of the Subprime Portfolio. This swap did not qualify as a hedge for accounting purposes and was therefore marked to market through income. An unrealized mark to market gain of \$5.5 million was recorded to Other Income in connection with this swap in March 2006.

In April 2006, Newcastle, through Newcastle Mortgage Securities Trust 2006-1 (the "Securitization Trust"), closed on a securitization of the Subprime Portfolio. The Securitization Trust is not consolidated by Newcastle. Newcastle sold the Subprime Portfolio and the related interest rate swap to the Securitization Trust. The Securitization Trust issued \$1.45 billion of debt (the "Notes"). Newcastle retained \$37.6 million face amount of the low investment grade Notes and all of the equity issued by the Securitization Trust. The Notes have a stated maturity of March 25, 2036. Newcastle, as holder of the equity of the Securitization Trust, has the option to redeem the Notes once the aggregate principal balance of the Subprime Portfolio is equal to or less than 20% of such balance at the date of the transfer. The proceeds from the securitization were used to repay the repurchase agreement described above.

The transaction between Newcastle and the Securitization Trust qualified as a sale for accounting purposes, resulting in a net gain of approximately \$40,000 being recorded in April 2006. However, 20% of the loans which are subject to future repurchase by Newcastle were not treated as being sold and are classified as "held for investment" subsequent to the completion of the securitization. Following the securitization, Newcastle held the following interests in the Subprime Portfolio, all valued at the date of securitization: (i) the \$62.4 million equity of the Securitization Trust, recorded in Real Estate Securities, Available for Sale, (ii) the \$33.7 million of retained bonds (\$37.6 million face amount), recorded in Real Estate Securities, Available for Sale, which have been financed with a \$28.0 million repurchase agreement, and (iii) subprime mortgage loans subject to future repurchase of \$286.3 million and related financing in the amount of 100% of such loans.

NEWCASTLE INVESTMENT CORP. AND SUBSIDIARIES

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(dollars in tables in thousands, except share data)

The key assumptions utilized in measuring the \$62.4 million fair value of the equity, or residual interest, in the Securitization Trust at the date of securitization were as follows:

Weighted average life (years) of residual interest	3.1
Expected credit losses	5.3%
Weighted average constant prepayment rate	28.0%
Discount rate	18.8%

The following table presents information on the retained interests in the securitization of the Subprime Portfolio, which include the residual interest and the retained bonds described above, and the sensitivity of their fair value to immediate 10% and 20% adverse changes in the assumptions utilized in calculating such fair value, at September 30, 2006:

Total securitized loans (unpaid principal balance)	\$	1,304,950
Loans subject to future repurchase (carrying value)	\$	287,546
Retained interests (fair value)	\$	84,393
Weighted average life (years) of residual interest		2.78
Expected credit losses		5.3%
Effect on fair value of retained interests of 10% adverse change	\$	(2,533)
Effect on fair value of retained interests of 20% adverse change	\$	(4,681)
Weighted average constant prepayment rate		28.0%
Effect on fair value of retained interests of 10% adverse change	\$	(3,507)
Effect on fair value of retained interests of 20% adverse change	\$	(6,005)
Discount rate		18.8%
Effect on fair value of retained interests of 10% adverse change	\$	(2,393)
Effect on fair value of retained interests of 20% adverse change	\$	(4,695)

The sensitivity analysis is hypothetical and should be used with caution. In particular, the results are calculated by stressing a particular economic assumption independent of changes in any other assumption; in practice, changes in one factor may result in changes in another, which might counteract or amplify the sensitivities. Also, changes in the fair value based on a 10% or 20% variation in an assumption generally may not be extrapolated because the relationship of the change in the assumption to the change in fair value may not be linear.

The following table summarizes principal amounts outstanding and delinquencies of the securitized loans as of September 30, 2006 and net credit losses for the period then ended:

Loan unpaid principal balance (UPB)	\$	1,304,950
Delinquencies of 60 or more days (UPB)	\$	26,020
Net credit losses	\$	-

Newcastle received net proceeds of \$1.41 billion from the securitization transaction completed in April 2006 and net cash inflows of \$20.3 million from the retained interests subsequent to the securitization.

The weighted average yield of the retained bonds was 11.01% and the weighted average funding cost of the related repurchase agreement was 5.83% as of September 30, 2006. The loans subject to future repurchase and the corresponding financing recognize interest income and expense based on the expected weighted average coupon of the loans subject to future repurchase at the call date of 9.24%.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

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6. RECENT ACTIVITIES

In January 2006, Newcastle closed on a three year term financing of its manufactured housing loan portfolio which provided for an initial financing amount of approximately \$237.1 million. The financing bears interest at LIBOR + 1.25%. The lender received an upfront structuring fee equal to 0.75% of the initial financing amount. Newcastle entered into an interest rate swap in order to hedge its exposure to the risk of changes in market interest rates with respect to this debt. In connection with this term financing, Newcastle renewed its servicing agreement on these loans, with a portfolio company of a private equity fund advised by an affiliate of its manager, at the same terms.

In 2006, employees of the Manager exercised options to acquire 84,000 shares of Newcastle's common stock for net proceeds of \$1.4 million.

In March 2006, Newcastle foreclosed on \$12.2 million of loans formerly in the ICH portfolio. The related real estate is considered held for investment.

In March 2006, Newcastle completed the placement of \$100 million of trust preferred securities through its wholly owned subsidiary, Newcastle Trust I (the "Preferred Trust"). Newcastle owns all of the common stock of the Preferred Trust. The Preferred Trust used the proceeds to purchase \$100.1 million of Newcastle's junior subordinated notes. These notes represent all of the Preferred Trust's assets. The terms of the junior subordinated notes are substantially the same as the terms of the trust preferred securities. The trust preferred securities require quarterly distributions at a fixed rate of 7.574% through April 2016 and at a floating rate of 3-month LIBOR plus 2.25% thereafter. The trust preferred securities mature in April 2036, but may be redeemed at par beginning in April 2011. Under the provisions of FIN 46R, Newcastle determined that the holders of the trust preferred securities were the primary beneficiaries of the Preferred Trust. As a result, Newcastle did not consolidate the Preferred Trust and has reflected the obligation to the Preferred Trust under the caption Junior Subordinated Notes Payable in its consolidated balance sheet and will account for its investment in the common stock of the Preferred Trust, which is reflected in Investments in Unconsolidated Subsidiaries in the consolidated balance sheet, under the equity method of accounting.

In May 2006, Newcastle entered into a new \$200.0 million revolving credit facility, secured by substantially all of its unencumbered assets and its equity interests in its subsidiaries. Newcastle paid an upfront fee of 0.25% of the total commitment. The credit facility bears interest at one month LIBOR + 1.75% and matures in November 2007. The credit facility does not contain any unused fees. Newcastle simultaneously terminated its prior credit facility and recorded a loss of \$0.7 million related to deferred financing costs, included in Gain on Sale of Investments, Net.

In June 2006, Newcastle entered into a warehouse agreement with a major investment bank to finance a portfolio of real estate related loans and securities prior to them being financed with a CBO. The financing bears interest at LIBOR + 0.50%. As of September 30, 2006, \$695.8 million face amount of investments were financed with \$572.5 million of debt, which has been classified as a Repurchase Agreement.

In July 2006, private equity funds managed by an affiliate of Newcastle's manager completed the acquisition of a subprime home equity mortgage lender ("Subprime Servicer"). Newcastle's portfolio of subprime loans, which was securitized in April, is being serviced by the Subprime Servicer for a servicing fee equal to 0.5% per annum on the unpaid principal balance of the portfolio.

In August 2006, Newcastle acquired a portfolio of approximately 13,300 manufactured housing loans for an aggregate purchase price of approximately \$425.4 million. The loans, 96% of which were current or less than 30 days delinquent at the time of acquisition, are 82% fixed rate and 18% adjustable rate. Their weighted average gross coupon was 10.0% and the loans had a weighted average remaining term to maturity of 213 months at acquisition. The acquisition was funded with \$391.3 million of five year notes bearing interest at one month LIBOR + 1.25%. The lender received an upfront fee of 0.5% on the initial financing amount and is entitled to expense reimbursement of up to 0.125% on the initial financing amount. Newcastle entered into interest rate swaps to hedge its exposure to the risk of changes in market interest rates with respect to this financing. The loans are serviced by a portfolio company of a private equity fund advised by an affiliate of our manager.

In November 2006, Newcastle sold 1.7 million shares of its common stock in a public offering at a price to the public of \$29.42 per share, for net proceeds of approximately \$49.5 million. For the purpose of compensating the Manager for its successful efforts in raising capital for Newcastle, in connection with this offering, Newcastle granted options to the Manager to purchase 170,000 shares of Newcastle's common stock at the public offering price, which were valued at approximately \$0.5 million.

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7. DERIVATIVE INSTRUMENTS

The following table summarizes the notional amounts and fair (carrying) values of Newcastle's derivative financial instruments, excluding the credit derivative arrangements described in Note 4, as of September 30, 2006.

	<u>Notional Amount</u>	<u>Fair Value</u>	<u>Longest Maturity</u>
Interest rate swaps, treated as hedges (A)	\$ 3,838,625	\$ 37,139	April 2017
Interest rate caps, treated as hedges (A)	342,351	1,677	October 2015
Non-hedge derivative obligations (A) (B)	147,500	(444)	July 2038

(A) Included in Derivative Assets or Derivative Liabilities, as applicable. Derivative Liabilities also include accrued interest.

(B) Represents two essentially offsetting interest rate caps and two essentially offsetting interest rate swaps, each with notional amounts of \$32.5 million and an interest rate cap with a notional amount of \$17.5 million.

8. EARNINGS PER SHARE

Newcastle is required to present both basic and diluted earnings per share ("EPS"). Basic EPS is calculated by dividing net income available for common stockholders by the weighted average number of shares of common stock outstanding during each period. Diluted EPS is calculated by dividing net income available for common stockholders by the weighted average number of shares of common stock outstanding plus the additional dilutive effect of common stock equivalents during each period. Newcastle's common stock equivalents are its outstanding stock options. Net income available for common stockholders is equal to net income less preferred dividends.

The following is a reconciliation of the weighted average number of shares of common stock outstanding on a diluted basis.

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
Weighted average number of shares of common stock outstanding, basic	43,999,817	43,789,819	43,978,625	43,595,411
Dilutive effect of stock options, based on the treasury stock method	137,139	331,444	112,378	365,633
Weighted average number of shares of common stock outstanding, diluted	<u>44,136,956</u>	<u>44,121,263</u>	<u>44,091,003</u>	<u>43,961,044</u>

As of September 30, 2006, Newcastle's outstanding options were summarized as follows:

Held by the Manager	1,193,439
Issued to the Manager and subsequently transferred to certain of the Manager's employees	520,368
Held by the independent directors	<u>14,000</u>
Total	<u>1,727,807</u>

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following should be read in conjunction with the unaudited consolidated financial statements and notes included herein.

GENERAL

Newcastle Investment Corp. is a real estate investment and finance company. We invest in real estate securities, loans and other real estate related assets. In addition, we consider other opportunistic investments which capitalize on our manager's expertise and which we believe present attractive risk/return profiles and are consistent with our investment guidelines. We seek to deliver stable dividends and attractive risk-adjusted returns to our stockholders through prudent asset selection, active management and the use of match funded financing structures, which reduce our interest rate and financing risks. Our objective is to maximize the difference between the yield on our investments and the cost of financing these investments while hedging our interest rate risk. We emphasize asset quality, diversification, match funded financing and credit risk management.

We currently own a diversified portfolio of moderately credit sensitive real estate debt investments including securities and loans. Our portfolio of real estate securities includes commercial mortgage backed securities (CMBS), senior unsecured debt issued by property REITs, real estate related asset backed securities (ABS), and agency residential mortgage backed securities (RMBS). Mortgage backed securities are interests in or obligations secured by pools of mortgage loans. We generally target investments rated A through BB, except for our agency RMBS which are generally considered AAA rated. We also own, directly and indirectly, interest in loans and pools of loans, including real estate related loans, commercial mortgage loans, residential mortgage loans, manufactured housing loans, and subprime mortgage loans. We also own, directly and indirectly, interests in operating real estate.

We employ leverage in order to achieve our return objectives. We do not have a predetermined target debt to equity ratio as we believe the appropriate leverage for the particular assets we are financing depends on the credit quality of those assets. As of September 30, 2006, our debt to equity ratio was approximately 7.4 to 1. Also, on a pro forma basis, our debt to equity ratio would be 6.6 to 1 if the trust preferred securities we issued in March 2006 were considered equity for purposes of this computation. We maintain access to a broad array of capital resources in an effort to insulate our business from potential fluctuations in the availability of capital. We utilize multiple forms of financing including collateralized bond obligations (CBOs), other securitizations, term loans, and trust preferred securities, as well as short term financing in the form of repurchase agreements and our credit facility.

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

Market Considerations

Our ability to maintain our dividends and grow our business is dependent on our ability to invest our capital on a timely basis at yields which exceed our cost of capital. The primary market factor that bears on this is credit spread.

Generally speaking, tightening credit spreads increase the unrealized gains on our current investments but reduce the yields available on potential new investments, while widening credit spreads reduce the unrealized gains on our current investments (or cause unrealized losses) but increase the yields available on potential new investments.

In the first nine months of 2006, credit spreads again tightened, reducing the yield we can earn on certain new investments. This tightening of credit spreads and declining interest rates caused the net unrealized gains on our securities and derivatives, recorded in accumulated other comprehensive income, and therefore our book value per share, to increase.

We continue to pursue opportunistic investments within our investment guidelines that offer a more attractive risk adjusted return, including our recent investments in subprime mortgage loans and other real estate related loans which we expect to produce a net, loss adjusted yield in the high teens.

If credit spreads widen, we expect that our new investment activities will benefit and our earnings will increase, although our net book value per share may decrease.

Certain aspects of these effects are more fully described in “Management’s Discussion and Analysis of Financial Condition and Results of Operations - Interest Rate, Credit and Spread Risk” as well as in “Quantitative and Qualitative Disclosures About Market Risk.”

Organization

Our initial public offering occurred in October 2002. The following table presents information on shares of our common stock issued since our formation:

Year	Shares Issued	Range of Issue Prices (1)	Net Proceeds (millions)
Formation	16,488,517	N/A	N/A
2002	7,000,000	\$13.00	\$80.0
2003	7,886,316	\$20.35-\$22.85	\$163.4
2004	8,484,648	\$26.30-\$31.40	\$224.3
2005	4,053,928	\$29.60	\$108.2
Nine Months Ended 2006	86,408	N/A	\$1.4
September 30, 2006	43,999,817		
November 2006	1,700,000	\$29.42	\$49.5

(1) Excludes prices of shares issued pursuant to the exercise of options and shares issued to Newcastle's independent directors.

As of September 30, 2006, approximately 2.9 million shares of our common stock were held by an affiliate of our manager and its principals. In addition, an affiliate of our manager held options to purchase approximately 1.2 million shares of our common stock at September 30, 2006.

We are organized and conduct our operations to qualify as a REIT for U.S. federal income tax purposes. As such, we will generally not be subject to U.S. federal corporate income tax on that portion of our income that is distributed to stockholders if we distribute at least 90% of our REIT taxable income to our stockholders by prescribed dates and comply with various other requirements.

We conduct our business by investing in three primary business segments: (i) real estate securities and real estate related loans, (ii) residential mortgage loans and (iii) operating real estate.

Revenues attributable to each segment are disclosed below (unaudited) (in thousands).

For the Nine Months Ended September 30,	Real Estate Securities and Real Estate Related Loans		Residential Mortgage Loans	Operating Real Estate	Unallocated	Total
2006	\$ 317,138	\$ 75,878	\$ 3,851	\$ (196)	\$ 396,671	
2005	\$ 232,803	\$ 37,270	\$ 4,892	\$ 613	\$ 275,578	

APPLICATION OF CRITICAL ACCOUNTING POLICIES

Management's discussion and analysis of financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP"). The preparation of financial statements in conformity with GAAP requires the use of estimates and assumptions that could affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities and the reported amounts of revenue and expenses. Actual results could differ from these estimates. The following is a summary of our accounting policies that are most effected by judgments, estimates and assumptions.

Variable Interest Entities

In December 2003, Financial Accounting Standards Board Interpretation ("FIN") No. 46R "Consolidation of Variable Interest Entities" was issued as a modification of FIN 46. FIN 46R clarified the methodology for determining whether an entity is a variable interest entity ("VIE") and the methodology for assessing who is the primary beneficiary of a VIE. VIEs are defined as entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. A VIE is required to be consolidated by its primary beneficiary, and only by its primary beneficiary, which is defined as the party who will absorb a majority of the VIE's expected losses or receive a majority of the expected residual returns as a result of holding variable interests.

Prior to FIN 46R, we consolidated our existing CBO transactions (the "CBO Entities") because we own the entire equity interest in each of them, representing a substantial portion of their capitalization, and we control the management and resolution of their assets. We have determined that certain of the CBO Entities are VIEs and that we are the primary beneficiary of each of these VIEs and therefore continue to consolidate them. We have also determined that the application of FIN 46R did not result in a change in our accounting for any other entities which were previously consolidated. However, it did cause us to consolidate one entity which was previously not consolidated, ICH CMO, as described below under "Liquidity and Capital Resources." Furthermore, as a result of FIN 46R, we are precluded from consolidating our wholly owned subsidiary which has issued trust preferred securities as described in "Liquidity and Capital Resources" below. We will continue to analyze future CBO entities, as well as other investments, pursuant to the requirements of FIN 46R. These analyses require considerable judgment in determining the primary beneficiary of a VIE since they involve subjective probability weighting of subjectively determined possible cash flow scenarios. The result could be the consolidation of an entity acquired or formed in the future that would otherwise not have been consolidated or the non-consolidation of such an entity that would otherwise have been consolidated.

Valuation and Impairment of Securities

We have classified our real estate securities as available for sale. As such, they are carried at fair value with net unrealized gains or losses reported as a component of accumulated other comprehensive income. Fair value is based primarily upon broker quotations, as well as counterparty quotations, which provide valuation estimates based upon reasonable market order indications or a good faith estimate thereof. These quotations are subject to significant variability based on market conditions, such as interest rates and credit spreads. Changes in market conditions, as well as changes in the assumptions or methodology used to determine fair value, could result in a significant increase or decrease in our book equity. We must also assess whether unrealized losses on securities, if any, reflect a decline in value which is other than temporary and, accordingly, write the impaired security down to its value through earnings. For example, a decline in value is deemed to be other than temporary if it is probable that we will be unable to collect all amounts due according to the contractual terms of a security which was not impaired at acquisition, or if we do not have the ability and intent to hold a security in an unrealized loss position until its anticipated recovery (if any). Temporary declines in value generally result from changes in market factors, such as market interest rates and credit spreads, or from certain macroeconomic events, including market disruptions and supply changes, which do not directly impact our ability to collect amounts contractually due. We continually evaluate the credit status of each of our securities and the collateral supporting our securities. This evaluation includes a review of the credit of the issuer of the security (if applicable), the credit rating of the security, the key terms of the security (including credit support), debt service coverage and loan to value ratios, the performance of the pool of underlying loans and the estimated value of the collateral supporting such loans, including the effect of local, industry and broader economic trends and factors. These factors include loan default expectations and loss severities, which are analyzed in connection with a particular security's credit support, as well as prepayment rates. The result of this evaluation is considered in relation to the amount of the unrealized loss and the period elapsed since it was incurred. Significant judgment is required in this analysis.

Revenue Recognition on Securities

Income on these securities is recognized using a level yield methodology based upon a number of cash flow assumptions that are subject to uncertainties and contingencies. Such assumptions include the rate and timing of principal and interest receipts (which may be subject to prepayments and defaults). These assumptions are updated on at least a quarterly basis to reflect changes related to a particular security, actual historical data, and market changes. These uncertainties and contingencies are difficult to predict and are subject to future events, and economic and market conditions, which may alter the assumptions. For securities acquired at a discount for credit losses, the net income recognized is based on a "loss adjusted yield" whereby a gross interest yield is recorded to Interest Income, offset by a provision for probable, incurred credit losses which is accrued on a periodic basis to Provision for Credit Losses. The provision is determined based on an evaluation of the credit status of securities, as described in connection with the analysis of impairment above.

Valuation of Derivatives

Similarly, our derivative instruments are carried at fair value pursuant to Statement of Financial Accounting Standards ("SFAS") No. 133 "Accounting for Derivative Instruments and Hedging Activities," as amended. Fair value is based on counterparty quotations. To the extent they qualify as cash flow hedges under SFAS No. 133, net unrealized gains or losses are reported as a component of accumulated other comprehensive income; otherwise, they are reported currently in income. To the extent they qualify as fair value hedges, net unrealized gains or losses on both the derivative and the related portion of the hedged item are reported currently in income. Fair values of such derivatives are subject to significant variability based on many of the same factors as the securities discussed above. The results of such variability could be a significant increase or decrease in our book equity and/or earnings.

Impairment of Loans

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

Revenue Recognition on Loans

Income on these loans is recognized similarly to that on our securities and is subject to similar uncertainties and contingencies, which are also analyzed on at least a quarterly basis. For loan pools acquired at a discount for credit losses, the net income recognized is based on a "loss adjusted yield" whereby a gross interest yield is recorded to Interest Income, offset by a provision for probable, incurred credit losses which is accrued on a periodic basis to Provision for Credit Losses. The provision is determined based on an evaluation of the loans as described under "Impairment of Loans" above. A rollforward of the provision is included in Note 4 to our consolidated financial statements.

Impairment of Operating Real Estate

We own operating real estate held for investment. We review our operating real estate for impairment annually or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Upon determination of impairment, we would record a write-down of the asset, which would be charged to earnings. Significant judgment is required both in determining impairment and in estimating the resulting write-down. To date, we have determined that no write-downs have been necessary on the operating real estate in our portfolio. In addition, when operating real estate is classified as held for sale, it must be recorded at the lower of its carrying amount or fair value less costs of sale. Significant judgment is required in determining the fair value of such properties.

Accounting Treatment for Certain Investments Financed with Repurchase Agreements

We owned \$491.0 million of assets purchased from particular counterparties which are financed via \$413.6 million of repurchase agreements with the same counterparties at September 30, 2006. Currently, we record such assets and the related financings gross on our balance sheet, and the corresponding interest income and interest expense gross on our income statement. In addition, if the asset is a security, any change in fair value is reported through other comprehensive income (since it is considered "available for sale").

However, in a transaction where assets are acquired from and financed under a repurchase agreement with the same counterparty, the acquisition may not qualify as a sale from the seller's perspective; in such cases, the seller may be required to continue to consolidate the assets sold to us, based on their "continuing involvement" with such investments. The result is that we may be precluded from presenting the assets gross on our balance sheet as we currently do, and may instead be required to treat our net investment in such assets as a derivative.

If it is determined that these transactions should be treated as investments in derivatives, the interest rate swaps entered into by us to hedge our interest rate exposure with respect to these transactions would no longer qualify for hedge accounting, but would, as the underlying asset transactions, also be marked to market through the income statement.

This potential change in accounting treatment does not affect the economics of the transactions but does affect how the transactions are reported in our financial statements. Our cash flows, our liquidity and our ability to pay a dividend would be unchanged, and we do not believe our taxable income would be affected. Our net income and net equity would not be materially affected. In addition, this would not affect Newcastle's status as a REIT or cause it to fail to qualify for its Investment Company Act exemption. This issue has been submitted to accounting standard setters for resolution. If we were to change our current accounting treatment for these transactions, our total assets and total liabilities would each be reduced by approximately \$414.4 million at September 30, 2006.

RESULTS OF OPERATIONS

The following table summarizes the changes in our results of operations from the three and nine months ended September 30, 2005 to the three and nine months ended September 30, 2006 (dollars in thousands):

	Period to Period Change		Period to Period Percent Change		Explanation
	Nine Months Ended September 30, 2006/2005	Three Months Ended September 30, 2006/2005	Nine Months Ended September 30, 2006/2005	Three Months Ended September 30, 2006/2005	
Interest income	\$ 124,411	\$ 52,309	49.0%	59.4%	(1)
Rental and escalation income	(1,234)	(1,037)	(25.4%)	(55.4%)	(2)
Gain on sale of investments	(2,035)	(4,108)	(16.8%)	(60.9%)	(3)
Other income	(49)	(2,920)	(1.1%)	(91.0%)	(4)
Interest expense	101,875	41,558	62.4%	70.8%	(1)
Property operating expense	981	447	53.7%	75.3%	(2)
Loan and security servicing expense	315	70	6.8%	4.7%	(1)
Provision for credit losses	(122)	(1,409)	(2.0%)	(34.4%)	(5)
Provision for losses, loans held for sale	4,127	-	N/A	N/A	(6)
General and administrative expense	728	153	22.4%	14.8%	(7)
Management fee to affiliate	525	159	5.3%	4.8%	(8)
Incentive compensation to affiliate	3,509	678	66.6%	28.1%	(8)
Depreciation and amortization	314	108	69.4%	59.3%	(9)
Equity in earnings of unconsolidated subsidiaries	(391)	445	(9.1%)	41.9%	(10)
Income from continuing operations	<u>\$ 8,450</u>	<u>\$ 2,925</u>	<u>9.9%</u>	<u>10.0%</u>	

(1) Changes in interest income and expense are primarily related to our acquisition and disposition during the periods of interest bearing assets and related financings, as follows:

	Nine Months Ended September 30, 2006/2005		Three Months Ended September 30, 2006/2005	
	Period to Period Increase (Decrease)		Period to Period Increase (Decrease)	
	Interest Income	Interest Expense	Interest Income	Interest Expense
Real estate security and loan portfolios (A)	\$ 44,938	\$ 35,284	\$ 19,788	\$ 14,235
Agency RMBS	19,016	18,216	6,730	6,523
Other real estate related loans	33,502	11,190	12,179	3,864
Subprime mortgage loan portfolio	31,467	22,523	10,078	7,144
Credit facility and junior subordinated notes	-	7,523	-	3,665
Manufactured housing loan portfolio (D)	7,715	4,675	6,042	4,398
Other (B)	7,175	13,031	2,706	5,018
Other real estate related loans (C)	(13,898)	(7,418)	(3,713)	(1,935)
Residential mortgage loan portfolio (C)	(5,504)	(3,149)	(1,501)	(1,354)
	<u>\$ 124,411</u>	<u>\$ 101,875</u>	<u>\$ 52,309</u>	<u>\$ 41,558</u>

(A) Represents the collateral for our most recent CBO financings.

(B) Primarily due to increasing interest rates on floating rate assets and liabilities owned during the entire period.

(C) These loans received paydowns during the period which served to offset the amounts listed above.

(D) Primarily due to the acquisition of a manufactured housing loan pool in the third quarter of 2006.

Changes in loan and security servicing expense are also primarily due to these acquisitions and paydowns.

(2) These changes are primarily the result of the effect of the termination of a lease (including the acceleration of lease termination income), the inception of a new lease (including the associated free rent period), foreign currency fluctuations, and the acquisition of a \$12.2 million portfolio of properties through foreclosure in the first quarter of 2006.

(3) This change is primarily a result of the volume of sales of real estate securities. Sales of real estate securities are based on a number of factors including credit, asset type and industry and can be expected to increase or decrease from time to time. Periodic fluctuations in the volume of sales of securities is dependent upon, among other things, management's assessment of credit risk, asset concentration, portfolio balance and other factors. In addition, this item includes a \$0.7 million loss recorded in connection with the refinancing of our credit facility in the second quarter of 2006.

(4) This change is primarily the result of investments financed with total rate of return swaps which we treat as non-hedge derivatives and mark to market through the income statement, which is offset by the \$5.5 million gain recorded in the first half of 2006 on the derivative used to hedge the interim financing of our subprime mortgage loans, which did not qualify as a hedge for accounting purposes. This gain was offset by the loss described in (6) below.

- (5) The change for the nine months is primarily due to less impairment recorded with respect to the ICH loans which is offset by an increase as a result of the acquisition of manufactured housing and residential mortgage loan pools at a discount related to credit. The change for the three months is primarily due to the impairment recorded with respect to ICH loans in the third quarter of 2005.
- (6) This change represents the unrealized loss on our pool of subprime mortgage loans which was considered held for sale at March 31, 2006. This loss was related to market factors and was offset by the gain described in (4) above.
- (7) The increase in general and administrative expense is primarily a result of increased professional fees.
- (8) The increase in management fees is a result of our increased size resulting from our equity issuances. The increase in incentive compensation is primarily a result of increased funds from operations, as described below under "Funds from Operations".
- (9) The increase in depreciation is primarily due to the acquisition of new information systems and the acquisition of a \$12.2 million portfolio of properties through foreclosure in the first quarter of 2006.
- (10) The decrease in earnings from unconsolidated subsidiaries for the nine months ended September 30, 2006 is primarily the result of a decrease in earnings from an LLC which owns franchise loans. During the periods presented, our investment in this LLC decreased due to return of capital distributions resulting in a corresponding reduction in earnings. The increase for the three months ended September 30, 2006 is primarily due to an income tax refund to a taxable subsidiary.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity is a measurement of our ability to meet potential cash requirements, including ongoing commitments to repay borrowings, fund and maintain investments, and other general business needs. Additionally, to maintain our status as a REIT under the Internal Revenue Code, we must distribute annually at least 90% of our REIT taxable income. Our primary sources of funds for liquidity consist of net cash provided by operating activities, borrowings under loans, and the issuance of debt and equity securities. Additional sources of liquidity include investments that are readily saleable prior to their maturity. Our debt obligations are generally secured directly by our investment assets.

We expect that our cash on hand and our cash flow provided by operations, as well as our credit facility, will satisfy our liquidity needs with respect to our current investment portfolio over the next twelve months. However, we currently expect to seek additional capital in order to grow our investment portfolio. We have an effective shelf registration statement with the SEC which allows us to issue various types of securities, such as common stock, preferred stock, depository shares, debt securities and warrants, from time to time, up to an aggregate of \$750 million, of which approximately \$261 million remained available as of November 1, 2006.

We expect to meet our long-term liquidity requirements, specifically the repayment of our debt obligations, through additional borrowings and the liquidation or refinancing of our assets at maturity. We believe that the value of these assets is, and will continue to be, sufficient to repay our debt at maturity under either scenario. Our ability to meet our long-term liquidity requirements relating to capital required for the growth of our investment portfolio is subject to obtaining additional equity and debt financing. Decisions by investors and lenders to enter into such transactions with us will depend upon a number of factors, such as our historical and projected financial performance, compliance with the terms of our current credit arrangements, industry and market trends, the availability of capital and our investors' and lenders' policies and rates applicable thereto, and the relative attractiveness of alternative investment or lending opportunities. We maintain access to a broad array of capital resources in an effort to insulate our business from potential fluctuations in the availability of capital.

Our ability to execute our business strategy, particularly the growth of our investment portfolio, depends to a significant degree on our ability to obtain additional capital. Our core business strategy is dependent upon our ability to finance our real estate securities, loans and other real estate related assets with match funded debt at rates that provide a positive net spread. If spreads for such liabilities widen or if demand for such liabilities ceases to exist, then our ability to execute future financings will be severely restricted. Furthermore, in an environment where spreads are tightening, if spreads tighten on the assets we purchase to a greater degree than they tighten on the liabilities we issue, our net spread will be reduced.

We expect to meet our short-term liquidity requirements generally through our cash flow provided by operations and our credit facility, as well as investment specific borrowings. In addition, at September 30, 2006 we had an unrestricted cash balance of \$16.3 million and an undrawn balance of \$75.0 million on our credit facility. Our cash flow provided by operations differs from our net income due to five primary factors: (i) accretion of discount or premium on our real estate securities and loans (including the accrual of interest and fees payable at maturity), discount on our debt obligations, deferred financing costs and interest rate cap premiums, and deferred hedge gains and losses, (ii) gains and losses from sales of assets financed with CBOs, (iii) depreciation and straight-lined rental income of our operating real estate, (iv) the provision for credit losses recorded in connection with our loan assets, and (v) unrealized gains or losses on our non-hedge derivatives, particularly our total return swaps. Proceeds from the sale of assets which serve as collateral for our CBO financings, including gains thereon, are required to be retained in the CBO structure until the related bonds are retired and are therefore not available to fund current cash needs.

Our match funded investments are financed long-term and their credit status is continuously monitored; therefore, these investments are expected to generate a generally stable current return, subject to interest rate fluctuations. See "Quantitative and Qualitative Disclosures About Market Risk -- Interest Rate Exposure" below. Our remaining investments, generally financed with short term repurchase agreements, are also subject to refinancing risk upon the maturity of the related debt. See "Debt Obligations" below.

With respect to our operating real estate, we expect to incur expenditures of approximately \$3.2 million relating to tenant improvements, in connection with the inception of leases, and capital expenditures during the twelve months ending September 30, 2007.

As described below, under "Interest Rate, Credit and Spread Risk," we are subject to margin calls in connection with our assets financed with repurchase agreements. We do not expect these potential margin calls to materially affect our financial condition or results of operations.

Debt Obligations

The following tables present certain information regarding our debt obligations and related hedges as of September 30, 2006 (unaudited) (dollars in thousands):

Debt Obligation/Collateral	Month Issued	Current Face Amount	Carrying Value	Unhedged Weighted Average Funding Cost	Final Stated Maturity	Weighted Average Funding Cost (1)	Weighted Average Maturity (Years)	Face Amount of Floating Rate Debt	Collateral Carrying Value	Collateral Weighted Average Maturity (Years)	Face Amount of Floating Rate Collateral	Aggregate Notional Amount of Current Hedges
CBO Bonds Payable												
Real estate securities	Jul 1999	\$ 398,970	\$ 396,060	6.58% (2)	Jul 2038	5.12%	2.25	\$ 303,970	\$ 545,452	4.26	\$ -	\$ 262,732
Real estate securities and loans	Apr 2002	444,000	441,500	6.51% (2)	Apr 2037	6.80%	3.70	372,000	499,025	5.47	59,849	296,000
Real estate securities and loans	Mar 2003	472,000	468,808	6.26% (2)	Mar 2038	5.36%	5.55	427,800	516,387	4.77	133,771	285,060
Real estate securities and loans	Sep 2003	460,000	456,098	6.07% (2)	Sep 2038	5.88%	6.11	442,500	506,289	4.58	135,545	207,500
Real estate securities and loans	Mar 2004	414,000	410,887	5.96% (2)	Mar 2039	5.40%	5.86	382,750	446,737	4.87	184,946	177,300
Real estate securities and loans	Sep 2004	454,500	451,011	5.94% (2)	Sep 2039	5.51%	6.44	442,500	498,845	5.17	227,746	209,261
Real estate securities and loans	Apr 2005	447,000	442,741	5.79% (2)	Apr 2040	5.53%	7.42	439,600	490,338	6.15	186,386	243,079
Real estate securities	Dec 2005	442,800	438,801	5.70% (2)	Dec 2050	5.48%	8.73	436,800	509,724	7.62	115,574	341,506
		<u>3,533,270</u>	<u>3,505,906</u>			<u>5.64%</u>	<u>5.80</u>	<u>3,247,920</u>	<u>4,012,797</u>	<u>5.39</u>	<u>1,043,817</u>	<u>2,022,438</u>
Other Bonds Payable												
ICH loans (3)	(3)	106,084	106,084	6.77% (2)	Aug 2030	6.77%	1.05	1,987	128,734	1.24	1,987	-
Manufactured housing loans	Jan 2006	218,635	217,000	LIBOR+1.25%	Jan 2009	6.14%	1.71	218,635	241,833	6.29	5,317	213,350
Manufactured housing loans	Aug 2006	384,518	381,701	LIBOR+1.25%	Aug 2011	6.94%	3.39	384,518	422,002	5.90	76,523	384,081
		<u>709,237</u>	<u>704,785</u>			<u>6.67%</u>	<u>2.52</u>	<u>605,140</u>	<u>792,569</u>	<u>5.27</u>	<u>83,827</u>	<u>597,431</u>
Notes Payable												
Residential mortgage loans (4)	Nov 2004	153,957	153,957	LIBOR+0.16%	Nov 2007	5.67%	0.84	153,957	172,902	2.79	168,807	-
		<u>153,957</u>	<u>153,957</u>			<u>5.67%</u>	<u>0.84</u>	<u>153,957</u>	<u>172,902</u>	<u>2.79</u>	<u>168,807</u>	<u>-</u>
Repurchase Agreements (4) (10)												
Agency RMBS (5)	Rolling	1,059,670	1,059,670	LIBOR+ 0.13%	Oct 2006	5.09%	0.08	1,059,670	1,091,728	4.33	-	1,016,135
Real estate securities and loans (6)	Jun 2006	572,509	572,509	LIBOR+ 0.50%	Dec 2006	5.83%	0.25	572,509	691,562	4.17	616,841	63,590
Real estate securities	Rolling	283,139	283,139	LIBOR+ 0.44%	Various (8)	5.79%	0.08	283,139	335,851	6.20	187,941	139,031
Real estate related loans	Rolling	257,115	257,115	LIBOR+ 0.63%	Oct 2006	5.97%	0.08	257,115	352,798	1.79	352,965	-
Residential mortgage loans	Rolling	25,347	25,347	LIBOR+ 0.43%	Dec 2006	5.79%	0.23	25,347	27,050	2.81	26,352	-
		<u>2,197,780</u>	<u>2,197,780</u>			<u>5.48%</u>	<u>0.13</u>	<u>2,197,780</u>	<u>2,498,989</u>	<u>4.18</u>	<u>1,184,099</u>	<u>1,218,756</u>
Credit facility (7)	May 2006	125,000	125,000	LIBOR+ 1.75%	Nov 2007	7.10%	1.09	125,000	-	-	-	-
Junior subordinated notes payable	Mar 2006	100,100	100,100	7.574% (9)	Apr 2036	7.62%	29.50	-	-	-	-	-
Subtotal debt obligations		<u>6,819,344</u>	<u>6,787,528</u>			<u>5.75%</u>	<u>3.78</u>	<u>\$ 6,329,797</u>	<u>\$ 7,477,257</u>	<u>4.90</u>	<u>\$ 2,480,550</u>	<u>\$ 3,838,625</u>
Financing on subprime mortgage loans subject to future repurchase (11)	Apr 2006	299,176	287,546									
Total debt obligations		<u>\$ 7,118,520</u>	<u>\$ 7,075,074</u>									

(1) Includes the effect of applicable hedges.

(2) Weighted average, including floating and fixed rate classes.

(3) See "Liquidity and Capital Resources" below regarding the consolidation of ICH CMO.

(4) Subject to potential mandatory prepayments based on collateral value.

(5) A maximum of \$1.125 billion is available until November 2006.

(6) A maximum of \$700 million is available under this warehouse agreement for the accumulation of collateral for the next CBO financing.

(7) A maximum of \$200 million can be drawn.

(8) The longest maturity is November 2006.

(9) LIBOR + 2.25% after April 2016.

(10) The counterparties on our repurchase agreements include: Bank of America Securities LLC (\$1,128 million), Bear Stearns Mortgage Capital Corporation (\$256 million), Credit Suisse (\$637 million), Deutsche Bank AG (\$177 million).

(11) See "Liquidity and Capital Resources" below.

Our debt obligations existing at September 30, 2006 (gross of \$43.4 million of discounts) had contractual maturities as follows (unaudited) (in thousands):

Period from October 1, 2006 through December 31, 2006	\$ 2,197,780
2007	278,957
2008	-
2009	218,635
2010	-
2011	384,518
Thereafter	<u>4,038,630</u>
Total	<u>\$ 7,118,520</u>

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

Two classes of CBO bonds, with an aggregate \$718.0 million face amount, were issued subject to remarketing procedures and related agreements whereby such bonds are remarketed and sold on a periodic basis. \$395.0 million of these bonds are fully insured by a third party with respect to the timely payment of interest and principal thereon.

In October 2003, pursuant to FIN No. 46R, we consolidated an entity which holds a portfolio of commercial mortgage loans which has been securitized. This investment, which we refer to as ICH, was previously treated as a non-consolidated residual interest in such securitization. The primary effect of the consolidation is the requirement that we reflect the gross loan assets and gross bonds payable of this entity in our financial statements.

In January 2006, we closed on a term financing of our manufactured housing loan portfolio which provided for an initial financing amount of approximately \$237.1 million. The lender received an upfront structuring fee equal to 0.75% on the initial financing amount and is entitled to expense reimbursement of up to 0.125% on the initial financing amount. We entered into an interest rate swap in order to hedge our exposure to the risk of changes in market interest rates with respect to this debt.

In March 2006, a consolidated subsidiary of ours acquired a portfolio of approximately 11,300 subprime mortgage loans (the "Subprime Portfolio") for \$1.50 billion. This acquisition was initially funded with an approximately \$1.47 billion repurchase agreement.

In April 2006, Newcastle Mortgage Securities Trust 2006-1 (the "Securitization Trust") closed on a securitization of the Subprime Portfolio. We do not consolidate the Securitization Trust. We sold the Subprime Portfolio to the Securitization Trust. The Securitization Trust issued \$1.45 billion of debt (the "Notes"). The Notes have a stated maturity of March 25, 2036. We, as holder of the equity of the Securitization Trust, have the option to redeem the Notes once the aggregate principal balance of the Subprime Portfolio is equal to or less than 20% of such balance at the date of the transfer. The proceeds from the securitization were used to repay the repurchase agreement described above.

The transaction between us and the Securitization Trust qualified as a sale for accounting purposes. However, 20% of the loans which are subject to future repurchase by us were not treated as being sold. Following the securitization, we held the following interests in the Subprime Portfolio, all valued at the date of securitization: (i) the \$62.4 million equity of the Securitization Trust, (ii) the \$33.7 million of retained bonds (\$37.6 million face amount), which have been financed with a \$28.0 million repurchase agreement, and (iii) subprime mortgage loans subject to future repurchase of \$286.3 million and related financing in the amount of 100% of such loans.

In March 2006, we completed the placement of \$100.0 million of trust preferred securities through our wholly owned subsidiary, Newcastle Trust I (the "Preferred Trust"). We own all of the common stock of the Preferred Trust. The Preferred Trust used the proceeds to purchase \$100.1 million of our junior subordinated notes. These notes represent all of the Preferred Trust's assets. The terms of the junior subordinated notes are substantially the same as the terms of the trust preferred securities. The trust preferred securities may be redeemed at par beginning in April 2011. We do not consolidate the Preferred Trust; as a result, we have reflected the obligation to the Preferred Trust under the caption Junior Subordinated Notes Payable.

In May 2006, we entered into a new \$200.0 million revolving credit facility, secured by substantially all of our unencumbered assets and our equity interests in our subsidiaries. We paid an upfront fee of 0.25% of the total commitment. The credit facility bears interest at one month LIBOR + 1.75% and matures in November 2007. We will not incur any unused fees. We simultaneously terminated our prior credit facility and recorded an expense of \$0.7 million related to deferred financing costs.

In August 2006, we completed our acquisition of a manufactured housing loan portfolio and closed on a five year term financing for an initial financing amount of approximately \$391.3 million bearing interest rate at one month LIBOR+1.25%. The lender received an upfront structuring fee equal to 0.5% on the initial financing amount and is entitled to expense reimbursement of up to 0.125% on the initial financing amount. We entered into interest rate swaps in order to hedge our exposure to the risk of changes in market interest rates with respect to this debt.

In November 2006, we priced our ninth CBO financing to term finance \$950 million portfolio of real estate securities and loans. We have agreed to issue, through a consolidated subsidiary of ours, \$807.5 million of investment grade debt in the offering, which is expected to close on November 16, 2006. At closing, the investment grade debt will have an initial weighted average spread over LIBOR of 0.48% and a weighted average life of 7 years. Approximately 69%, or \$560.5 million, of the investment grade debt is rated AAA.

Our debt obligations contain various customary loan covenants. Such covenants do not, in management's opinion, materially restrict our investment strategy or ability to raise capital. We are in compliance with all of our loan covenants as of September 30, 2006.

Other

We have entered into arrangements with a major investment bank to finance certain loans whereby we receive the sum of all interest, fees and any positive change in value amounts (the total return cash flows) from a reference asset with a specified notional amount, and pay interest on such notional plus any negative change in value amounts from such asset. These agreements are recorded in Derivative Assets and treated as non-hedge derivatives for accounting purposes and are therefore marked to market through income. Net interest received is recorded to Interest Income and the mark to market is recorded to Other Income. If we owned the reference assets directly, they would not be marked to market. Under the agreements, we are required to post an initial margin deposit to an interest bearing account and additional margin may be payable in the event of a decline in value of the reference asset. Any margin on deposit, less any negative change in value amounts, will be returned to us upon termination of the contract.

As of September 30, 2006, we held an aggregate of \$186.9 million notional amount of total rate of return swaps on 5 reference assets on which we had deposited \$29.2 million of margin. These total rate of return swaps had an aggregate fair value of approximately \$0.7 million, a weighted average receive interest rate of LIBOR + 2.54%, a weighted average pay interest rate of LIBOR + 0.53%, and a weighted average maturity of 1.3 years.

Stockholders' Equity

Common Stock

The following table presents information on shares of our common stock issued since December 31, 2005:

Period	Shares Issued	Range of Issue Prices (1)	Net Proceeds (millions)	Options Granted to Manager
Nine Months 2006	86,408	N/A	\$1.4	N/A

(1) Excludes prices of shares issued pursuant to the exercise of options and shares issued to our independent directors.

At September 30, 2006, we had 43,899,817 shares of common stock outstanding.

As of September 30, 2006, our outstanding options were summarized as follows:

Held by the Manager	1,193,439
Issued to the Manager and subsequently transferred to certain of the manager's employees	520,368
Held by the independent directors	<u>14,000</u>
Total	<u><u>1,727,807</u></u>

In November 2006, we sold 1.7 million shares of our common stock in a public offering at a price to the public at \$29.42 per share for net proceeds of approximately \$49.5 million. For the purpose of compensating the Manager for its successful efforts in raising capital for us, in connection with this offering, we granted options to the Manager to purchase 170,000 shares of our common stock at the public offering price, which were valued at approximately \$0.5 million.

Preferred Stock

In March 2003, we issued 2.5 million shares (\$62.5 million face amount) of 9.75% Series B Cumulative Redeemable Preferred Stock (the "Series B Preferred"). In October 2005, we issued 1.6 million shares (\$40.0 million face amount) of 8.05% Series C Cumulative Redeemable Preferred Stock (the "Series C Preferred"). The Series B Preferred and Series C Preferred have a \$25 liquidation preference, no maturity date and no mandatory redemption. We have the option to redeem the Series B Preferred beginning in March 2008 and the Series C Preferred beginning in October 2010.

Other Comprehensive Income

During the nine months ended September 30, 2006, our accumulated other comprehensive income changed due to the following factors (in thousands):

Accumulated other comprehensive income, December 31, 2005	\$	45,564
Net unrealized (loss) on securities		31,775
Reclassification of net realized (gain) on securities into earnings		(637)
Foreign currency translation		763
Net unrealized gain on derivatives designated as cash flow hedges		6,801
Reclassification of net realized (gain) on derivatives designated as cash flow hedges into earnings		(3,351)
Accumulated other comprehensive income, September 30, 2006	<u>\$</u>	<u>80,915</u>

Our book equity changes as our real estate securities portfolio and derivatives are marked-to-market each quarter, among other factors. The primary causes of mark-to-market changes are changes in interest rates and credit spreads. During the period, increasing interest rates and tightening credit spreads resulted in a net increase in unrealized gains on our real estate securities and derivatives. In an environment of widening credit spreads and increasing interest rates, we believe our new investment activities would benefit. While such an environment would likely result in a decrease in the fair value of our existing securities portfolio and, therefore, reduce our book equity and ability to realize gains on such existing securities, it would not directly affect our earnings or our cash flow or our ability to pay dividends.

Common Dividends Paid

<u>Declared for the Period Ended</u>	<u>Paid</u>	<u>Amount Per Share</u>
March 31, 2006	April 28, 2006	\$0.625
June 30, 2006	July 28, 2006	\$0.650
September 30, 2006	October 31, 2006	\$0.650

Cash Flow

Net cash flow provided by operating activities increased to \$114.0 million for the nine months ended September 30, 2006 from \$12.1 million for the nine months ended September 30, 2005. This change primarily resulted from the increase in restricted cash, offset by the acquisition and settlement of our investments as described above.

Investing activities (used) (\$1,596.5 million) and (\$844.1 million) during the nine months ended September 30, 2006 and 2005, respectively. Investing activities consisted primarily of investments made in certain real estate securities, loans and other real estate related assets, net of proceeds from the sale or settlement of investments.

Financing activities provided \$1,477.6 million and \$810.5 million during the nine months ended September 30, 2006 and 2005, respectively. The equity issuances, borrowings and debt issuances described above served as the primary sources of cash flow from financing activities. Offsetting uses included the payment of related deferred financing costs, the purchase of hedging instruments, the payment of dividends, and the repayment of debt as described above.

See the consolidated statements of cash flows included in our consolidated financial statements included herein for a reconciliation of our cash position for the periods described herein.

INTEREST RATE, CREDIT AND SPREAD RISK

We are subject to interest rate, credit and spread risk with respect to our investments.

Our primary interest rate exposures relate to our real estate securities, loans, floating rate debt obligations, interest rate swaps, and interest rate caps. Changes in the general level of interest rates can affect our net interest income, which is the difference between the interest income earned on interest-earning assets and the interest expense incurred in connection with our interest-bearing liabilities and hedges. Changes in the level of interest rates also can affect, among other things, our ability to acquire real estate securities and loans at attractive prices, the value of our real estate securities, loans and derivatives, and our ability to realize gains from the sale of such assets.

Our general financing strategy focuses on the use of match funded structures. This means that we seek to match the maturities of our debt obligations with the maturities of our investments to minimize the risk that we have to refinance our liabilities prior to the maturities of our assets, and to reduce the impact of changing interest rates on our earnings. In addition, we generally match fund interest rates on our investments with like-kind debt (i.e., fixed rate assets are financed with fixed rate debt and floating rate assets are financed with floating rate debt), directly or through the use of interest rate swaps, caps or other financial instruments, or through a combination of these strategies, which allows us to reduce the impact of changing interest rates on our earnings. See "Quantitative and Qualitative Disclosures About Market Risk - Interest Rate Exposure" below.

Interest rate changes may also impact our net book value as our real estate securities and related hedge derivatives are marked to market each quarter. Our loan investments and debt obligations are not marked to market. Generally, as interest rates increase, the value of our fixed rate securities decreases, and as interest rates decrease, the value of such securities will increase. In general, we would expect that over time, decreases in the value of our real estate securities portfolio attributable to interest rate changes will be offset to some degree by increases in the value of our swaps, and vice versa. However, the relationship between spreads on securities and spreads on swaps may vary from time to time, resulting in a net aggregate book value increase or decline. Our real estate securities portfolio is largely financed to maturity through long term CBO financings that are not redeemable as a result of book value changes. Accordingly, unless there is a material impairment in value that would result in a payment not being received on a security, changes in the book value of our securities portfolio will not directly affect our recurring earnings or our ability to pay dividends.

The commercial mortgage and asset backed securities we invest in are generally junior in right of payment of interest and principal to one or more senior classes, but benefit from the support of one or more subordinate classes of securities or other form of credit support within a securitization transaction. The senior unsecured REIT debt securities we invest in reflect comparable credit risk. Credit risk refers to each individual borrower's ability to make required interest and principal payments on the scheduled due dates. We believe, based on our due diligence process, that these securities offer attractive risk-adjusted returns with long term principal protection under a variety of default and loss scenarios. While the expected yield on these securities is sensitive to the performance of the underlying assets, the more subordinated securities or other features of the securitization transaction, in the case of commercial mortgage and asset backed securities, and the issuer's underlying equity and subordinated debt, in the case of senior unsecured REIT debt securities, are designed to bear the first risk of default and loss. We further minimize credit risk by actively monitoring our real estate securities portfolio and the underlying credit quality of our holdings and, where appropriate, repositioning our investments to upgrade the credit quality on our investments. While we have not experienced any significant credit losses, in the event of a significant rising interest rate environment and/or economic downturn, loan and collateral defaults may increase and result in credit losses that would adversely affect our liquidity and operating results.

Our real estate securities are also subject to spread risk. Our fixed rate securities are valued based on a market credit spread over the rate payable on fixed rate U.S. Treasuries of like maturity. In other words, their value is dependent on the yield demanded on such securities by the market based on their credit relative to U.S. Treasuries. Excessive supply of such securities combined with reduced demand will generally cause the market to require a higher yield on such securities, resulting in the use of a higher (or "wider") spread over the benchmark rate (usually the applicable U.S. Treasury security yield) to value such securities. Under such conditions, the value of our real estate securities portfolio would tend to decline. Conversely, if the spread used to value such securities were to decrease (or "tighten"), the value of our real estate securities portfolio would tend to increase. Our floating rate securities are valued based on a market credit spread over LIBOR and are affected similarly by changes in LIBOR spreads. Such changes in the market value of our real estate securities portfolio may affect our net equity, net income or cash flow directly through their impact on unrealized gains or losses on available-for-sale securities, and therefore our ability to realize gains on such securities, or indirectly through their impact on our ability to borrow and access capital. If the value of our securities subject to repurchase agreements were to decline, it could affect our ability to refinance such securities upon the maturity of the related repurchase agreements, adversely impacting our rate of return on such securities. See "Quantitative and Qualitative Disclosures About Market Risk - Credit Spread Exposure" below.

Furthermore, shifts in the U.S. Treasury yield curve, which represents the market's expectations of future interest rates, would also affect the yield required on our real estate securities and therefore their value. This would have similar effects on our real estate securities portfolio and our financial position and operations to a change in spreads.

Loans

Similar to our real estate securities portfolio, we are subject to credit and spread risk with respect to our real estate related, commercial mortgage and residential mortgage loan portfolios. However, unlike our real estate securities portfolio, our loans generally do not benefit from the support of junior classes of securities, but rather bear the first risk of default and loss. We believe that this credit risk is mitigated through our due diligence process and continual reviews of the borrower's payment history, delinquency status, and the relationship of the loan balance to the underlying property value.

Our loan portfolios are also subject to spread risk. Our floating rate loans are valued based on a market credit spread to LIBOR. The value of the loans is dependent upon the yield demanded by the market based on their credit relative to LIBOR. The value of our floating rate loans would tend to decline should the market require a higher yield on such loans, resulting in the use of a higher spread over the benchmark rate (usually the applicable LIBOR yield). Our fixed rate loans are valued based on a market credit spread over U.S. Treasuries and are effected similarly by changes in U.S. Treasury spreads. If the value of our loans subject to repurchase agreements were to decline, it could affect our ability to refinance such loans upon the maturity of the related repurchase agreements.

Any credit or spread losses incurred with respect to our loan portfolios would affect us in the same way as similar losses on our real estate securities portfolio as described above, except that our loan portfolios are not marked to market. Accordingly, unless there is a material impairment in value that would result in a payment not being received on a loan, changes in the value of our loan portfolio will not directly affect our recurring earnings or ability to pay dividends.

The face amount of our total portfolio was \$8.1 billion, which includes real estate securities and related loans (including agency RMBS) of \$6.7 billion, residential mortgage loans of \$0.9 billion, as well as other real estate related assets.

\$5.7 billion of the real estate securities and related loans were rated by third parties or implied AAA (agency RMBS) with an average rating of BBB+, \$1.0 billion of the real estate securities and real estate related loans (mezzanine loans, B-notes and real estate loans) were non-rated but had a weighted average loan to value ratio of 71.0%. Our average investment size in the real estate securities and related loan portfolio was \$9.8 million, with our largest single investment being \$123.1 million at September 30, 2006. The weighted average credit spread on this portfolio (i.e. the yield premium on our investments over the comparable U.S. Treasury rate or LIBOR) was 2.55%. Furthermore, our real estate securities are supported by pools of underlying loans. For instance, our CMBS investments had over 22,000 underlying loans. We expect this diversification helps to minimize the risk of capital loss, and will also enhance the terms of our financing structures.

Our residential mortgage loan portfolio was characterized by high credit quality borrowers with a weighted average FICO score of 706 at origination. Approximately \$168.8 million of the unpaid principal balance of the \$195.2 residential mortgage loan portfolio was held in securitized form, of which over 96.0% of the principal balance was rated investment grade.

Our loan portfolios are diversified by geographic location and by borrower. Our residential and manufactured housing loans were well diversified with 566 loans and 19,148 loans, respectively. We believe that this diversification also helps to minimize the risk of capital loss.

Margin

Certain of our investments are financed through repurchase agreements or total return swaps which are subject to margin calls based on the value of such investments. Margin calls resulting from decreases in value related to rising interest rates are substantially offset by our ability to make margin calls on our interest rate derivatives. We maintain adequate cash reserves or availability on our credit facility to meet any margin calls resulting from decreases in value related to a reasonably possible (in the opinion of management) widening of credit spreads. Funding a margin call on our credit facility would have a dilutive effect on our earnings, however we would not expect this to be material.

OFF-BALANCE SHEET ARRANGEMENTS

As of September 30, 2006, we had one material off-balance sheet arrangement.

- In April 2006, we securitized our portfolio of subprime mortgage loans. 80% of this transaction was treated as an off-balance sheet financing as described in "Liquidity and Capital Resources."

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

- We are party to total rate of return swaps which are treated as non-hedge derivatives. For further information on these investments, see "Liquidity and Capital Resources."
- We have made investments in three unconsolidated subsidiaries. See Note 2 to our consolidated financial statements.

In each case, our exposure to loss is limited to the carrying (fair) value of our investment, except for the total rate of return swaps where our exposure to loss is limited to their fair value plus their notional amount.

CONTRACTUAL OBLIGATIONS

During the first nine months of 2006, we had all of the material contractual obligations referred to in our annual report on Form 10-K for the year ended December 31, 2005, as well as the following:

Contract Category	Change
Repurchase agreements	We financed certain newly acquired loans and securities with repurchase agreements. We also entered into a warehouse agreement (structured in the form of a repurchase agreement) related to our next CBO financing.
Other bonds payable	One portfolio of manufactured housing loans was refinanced. We also entered into a term financing in connection with the purchase of a second manufactured housing loan portfolio.
Credit facility	We replaced our prior credit facility.
Junior subordinated notes payable	We issued the junior subordinated notes payable in connection with the issuance of trust preferred securities by our unconsolidated, wholly owned subsidiary.
Interest rate swaps, treated as hedges	Certain floating rate debt issuances, including those described above as well as an anticipated issuance, as well as certain assets, were hedged with interest rate swaps.
Loan servicing agreements	We renewed the agreement related to our manufactured housing loan portfolio at the same terms, and entered into an agreement related to our subprime mortgage loan portfolio.
Securitization	We entered into the securitization of our subprime mortgage loan portfolio.

The terms of these contracts are described under "Quantitative and Qualitative Disclosures About Market Risk" below.

INFLATION

We believe that our risk of increases in the market interest rates on our floating rate debt as a result of inflation is largely offset by our use of match funding and hedging instruments as described above. See "Quantitative and Qualitative Disclosure About Market Risk -- Interest Rate Exposure" below.

FUNDS FROM OPERATIONS

We believe FFO is one appropriate measure of the operating performance of real estate companies. We also believe that FFO is an appropriate supplemental disclosure of operating performance for a REIT due to its widespread acceptance and use within the REIT and analyst communities. Furthermore, FFO is used to compute our incentive compensation to the Manager. FFO, for our purposes, represents net income available for common stockholders (computed in accordance with GAAP), excluding extraordinary items, plus depreciation of operating real estate, and after adjustments for unconsolidated subsidiaries, if any. We consider gains and losses on resolution of our investments to be a normal part of our recurring operations and therefore do not exclude such gains and losses when arriving at FFO. Adjustments for unconsolidated subsidiaries, if any, are calculated to reflect FFO on the same basis. FFO does not represent cash generated from operating activities in accordance with GAAP and therefore should not be considered an alternative to net income as an indicator of our operating performance or as an alternative to cash flow as a measure of liquidity and is not necessarily indicative of cash available to fund cash needs. Our calculation of FFO may be different from the calculation used by other companies and, therefore, comparability may be limited.

Funds from Operations (FFO) is calculated as follows (unaudited) (in thousands):

	For the Nine Months Ended September 30, 2006	For the Three Months Ended September 30, 2006
Income available for common stockholders	\$ 86,991	\$ 29,699
Operating real estate depreciation	562	221
Funds from Operations (FFO)	<u>\$ 87,553</u>	<u>\$ 29,920</u>

Funds from Operations was derived from our segments as follows (unaudited) (in thousands):

	Book Equity at September 30, 2006	Average Invested Common Equity for the Nine Months Ended September 30, 2006(2)	FFO for the Nine Months Ended September 30, 2006	Return on Invested Common Equity (ROE) (3)
Real estate securities and real estate related loans	\$ 956,109	\$ 872,745	\$ 106,294	16.2%
Residential mortgage loans	135,641	104,031	15,908	20.4%
Operating real estate	46,783	45,920	2,997	8.7%
Unallocated (1)	<u>(360,674)</u>	<u>(232,168)</u>	<u>(37,646)</u>	N/A
Total (2)	777,859	<u>\$ 790,528</u>	<u>\$ 87,553</u>	<u>14.8%</u>
Preferred stock	102,500			
Accumulated depreciation	(4,108)			
Accumulated other comprehensive income	<u>80,915</u>			
Net book equity	<u>\$ 957,166</u>			

	Book Equity at September 30, 2006	Average Invested Common Equity for the Three Months Ended September 30, 2006(2)	FFO for the Three Months Ended September 30, 2006	Return on Invested Common Equity (ROE) (3)
Real estate securities and real estate related loans	\$ 956,109	\$ 921,822	\$ 37,882	16.4%
Residential mortgage loans	135,641	121,687	5,081	16.7%
Operating real estate	46,783	46,690	611	5.2%
Unallocated (1)	<u>(360,674)</u>	<u>(309,056)</u>	<u>(13,654)</u>	N/A
Total (2)	777,859	<u>\$ 781,143</u>	<u>\$ 29,920</u>	<u>15.3%</u>
Preferred stock	102,500			
Accumulated depreciation	(4,108)			
Accumulated other comprehensive income	<u>80,915</u>			
Net book equity	<u>\$ 957,166</u>			

(1) Unallocated FFO represents (\$6,985) and (\$2,328) of preferred dividends, (\$7,624) and (\$3,766) of interest on our credit facility and junior subordinated notes payable, and (\$23,037) and (\$7,560) of corporate general and administrative expenses, management fees and incentive compensation for the nine and three months ended September 30, 2006, respectively.

(2) Invested common equity is equal to book equity excluding preferred stock, accumulated depreciation and accumulated other comprehensive income.

(3) FFO divided by average invested common equity, annualized.

RELATED PARTY TRANSACTIONS

As of December 31, 2005, we owned an aggregate of approximately \$48.5 million of securities of Global Signal Trust I and II, special purpose vehicles established by Global Signal Inc., which were purchased in private placements from underwriters in January 2004 and April 2005. Our CEO and chairman of our board of directors is the chairman of the board of Global Signal, Inc. and private equity funds managed by an affiliate of our manager own a significant portion of Global Signal Inc.'s common stock. In February 2006, we purchased from an underwriter \$91.0 million face amount of BBB- and BB+ rated securities of Global Signal Trust III, a special purpose vehicle established by Global Signal, Inc. Pursuant to an underwritten 144A offering, approximately \$1,550.0 million of Global Signal Trust III securities were issued in 8 classes, rated AAA through BB+, of which the BBB- and BB+ classes aggregated \$188.3 million. The balance of the BBB- and BB+ securities were sold on identical terms to third parties. A portion of the proceeds were used to repay Global Signal, Inc. debt, including \$31.5 million of the Global Signal Trust I securities we owned, and to fund the prepayment penalty associated with this debt.

In January 2005, we entered into a servicing agreement with a portfolio company of a private equity fund advised by an affiliate of our manager for them to service a portfolio of manufactured housing loans, which was acquired at the same time. As compensation under the servicing agreement, the portfolio company will receive, on a monthly basis, a net servicing fee equal to 1.00% per annum on the unpaid principal balance of the loans being serviced. In January 2006, we closed on a new term financing of this portfolio. In connection with this term financing, we renewed our servicing agreement at the same terms.

In April 2006, we securitized our portfolio of subprime residential mortgage loans and, through the Securitization Trust, entered into a servicing agreement with a subprime home equity mortgage lender ("Subprime Servicer") to service this portfolio. In July 2006, private equity funds managed by an affiliate of our manager completed the acquisition of the Subprime Servicer. As compensation under the servicing agreement, the Subprime Servicer will receive, on a monthly basis, a net servicing fee equal to 0.5% per annum on the unpaid principal balance of the portfolio. The outstanding unpaid principal balance of this portfolio was approximately \$1.30 billion at September 30, 2006.

In August 2006, we acquired a portfolio of manufactured housing loans for an aggregate purchase price of \$425.4 million. The loans are being serviced by a portfolio company of a private equity fund advised by an affiliate of our manager. As compensation under the servicing agreement, the servicer will receive, on a monthly basis, a net servicing fee equal to 0.625% per annum on the unpaid principal balance of the portfolio plus an incentive fee if the performance of the loans meets certain thresholds. The outstanding unpaid principal balance of this portfolio was approximately \$419.9 million at September 30, 2006.

In September 2006, we were co-lenders with two private investment funds managed by an affiliate of our manager in a new real estate related loan of \$250.1 million. The loan is secured by a first mortgage interest on a parcel of land in Arizona. We own a 20% interest in the loan and the private investment funds own an 80% interest in the loan. Major decisions require the unanimous approval of the holders of interests in the loan, while other decisions require the approval of a majority of holders of interests in the loan. Newcastle and our affiliated investment funds are each entitled to transfer all or any portion of their respective interests in the loan to third parties. In October 2006, we and the private investment funds sold, on a pro-rata basis, a \$125.0 million senior participation interest in the loan to an unaffiliated third party resulting in a 20% interest in the junior participation interest in the loan. Our investment in this loan was approximately \$50.2 million at September 30, 2006.

As of September 30, 2006, we held total investments of \$193.8 million face amount of real estate securities and related loans issued by affiliates of our manager and earned approximately \$8.9 million of interest on such investments for the nine months ended September 30, 2006.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

Interest Rate Exposure

Our primary interest rate exposures relate to our real estate securities, loans, floating rate debt obligations, interest rate swaps, and interest rate caps. Changes in the general level of interest rates can affect our net interest income, which is the difference between the interest income earned on interest-earning assets and the interest expense incurred in connection with our interest-bearing liabilities and hedges. Changes in the level of interest rates also can affect, among other things, our ability to acquire real estate securities and loans at attractive prices, the value of our real estate securities, loans and derivatives, and our ability to realize gains from the sale of such assets. While our strategy is to utilize interest rate swaps, caps and match funded financings in order to limit the effects of changes in interest rates on our operations, there can be no assurance that our profitability will not be adversely affected during any period as a result of changing interest rates. In the event of a significant rising interest rate environment and/or economic downturn, loan and collateral defaults may increase and result in credit losses that would adversely affect our liquidity and operating results. As of September 30, 2006, a 100 basis point increase in short term interest rates would increase our earnings by approximately \$0.6 million per annum.

A period of rising interest rates as we are currently experiencing negatively impacts our return on certain investments, particularly our floating rate residential mortgage loans. Although these loans are financed with floating rate debt, the interest rate on the debt resets prior to, and in some cases more frequently than, the interest rate on the assets, causing a decrease in return on equity during a period of rising interest rates. When interest rates stabilize, we expect these investments will return to their historical returns on equity.

Interest rate changes may also impact our net book value as our real estate securities and related hedge derivatives are marked to market each quarter. Our loan investments and debt obligations are not marked to market. Generally, as interest rates increase, the value of our fixed rate securities decreases, and as interest rates decrease, the value of such securities will increase. In general, we would expect that over time, decreases in the value of our real estate securities portfolio attributable to interest rate changes will be offset to some degree by increases in the value of our swaps, and vice versa. However, the relationship between spreads on securities and spreads on swaps may vary from time to time, resulting in a net aggregate book value increase or decline. Our real estate securities portfolio is largely financed to maturity through long-term CBO financings that are not redeemable as a result of book value changes. Accordingly, unless there is a material impairment in value that would result in a payment not being received on a security, changes in the book value of our portfolio will not directly affect our recurring earnings or our ability to pay dividends. As of September 30, 2006, a 100 basis point change in short term interest rates would impact our net book value by approximately \$60.8 million.

Our general financing strategy focuses on the use of match funded structures. This means that we seek to match the maturities of our debt obligations with the maturities of our investments to minimize the risk that we have to refinance our liabilities prior to the maturities of our assets, and to reduce the impact of changing interest rates on our earnings. In addition, we generally match fund interest rates on our investments with like-kind debt (i.e., fixed rate assets are financed with fixed rate debt and floating rate assets are financed with floating rate debt), directly or through the use of interest rate swaps, caps, or other financial instruments, or through a combination of these strategies, which allows us to reduce the impact of changing interest rates on our earnings. Our financing strategy is dependent on our ability to place the match funded debt we use to finance our investments at rates that provide a positive net spread. If spreads for such liabilities widen or if demand for such liabilities ceases to exist, then our ability to execute future financings will be severely restricted.

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

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

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

Our hedging transactions using derivative instruments also involve certain additional risks such as counterparty credit risk, the enforceability of hedging contracts and the risk that unanticipated and significant changes in interest rates will cause a significant loss of basis in the contract. The counterparties to our derivative arrangements are major financial institutions with high credit ratings with which we and our affiliates may also have other financial relationships. As a result, we do not anticipate that any of these counterparties will fail to meet their obligations. There can be no assurance that we will be able to adequately protect against the foregoing risks and will ultimately realize an economic benefit that exceeds the related amounts incurred in connection with engaging in such hedging strategies.

Credit Spread Exposure

Our real estate securities are also subject to spread risk. Our fixed rate securities are valued based on a market credit spread over the rate payable on fixed rate U.S. Treasuries of like maturity. In other words, their value is dependent on the yield demanded on such securities by the market based on their credit relative to U.S. Treasuries. Excessive supply of such securities combined with reduced demand will generally cause the market to require a higher yield on such securities, resulting in the use of higher (or "wider") spread over the benchmark rate (usually the applicable U.S. Treasury security yield) to value such securities. Under such conditions, the value of our real estate securities portfolio would tend to decline. Conversely, if the spread used to value such securities were to decrease (or "tighten"), the value of our real estate securities portfolio would tend to increase. Our floating rate securities are valued based on a market credit spread over LIBOR and are affected similarly by changes in LIBOR spreads. Such changes in the market value of our real estate securities portfolio may affect our net equity, net income or cash flow directly through their impact on unrealized gains or losses on available-for-sale securities, and therefore our ability to realize gains on such securities, or indirectly through their impact on our ability to borrow and access capital.

Furthermore, shifts in the U.S. Treasury yield curve, which represents the market's expectations of future interest rates, would also effect the yield required on our real estate securities and therefore their value. This would have similar effects on our real estate securities portfolio and our financial position and operations to a change in spreads.

Our loan portfolios are also subject to spread risk. Our floating rate loans are valued based on a market credit spread to LIBOR. The value of the loans is dependent upon the yield demanded by the market based on their credit relative to LIBOR. The value of our floating rate loans would tend to decline should the market require a higher yield on such loans, resulting in the use of a higher spread over the benchmark rate (usually the applicable LIBOR yield). Our fixed rate loans are valued based on a market credit spread over U.S. Treasuries and are effected similarly by changes in U.S. Treasury spreads. If the value of our loans subject to repurchase agreements were to decline, it could affect our ability to refinance such loans upon the maturity of the related repurchase agreements.

Any decreases in the value of our loan portfolios due to spread changes would affect us in the same way as similar changes to our real estate securities portfolio as described above, except that our loan portfolios are not marked to market.

As of September 30, 2006, a 25 basis point movement in credit spreads would impact our net book value by approximately \$62.3 million, but would not directly affect our earnings or cash flow.

Margin

Certain of our investments are financed through repurchase agreements or total return swaps which are subject to margin calls based on the value of such investments. Margin calls resulting from decreases in value related to rising interest rates are substantially offset by our ability to make margin calls on our interest rate derivatives. We maintain adequate cash reserves or availability on our credit facility to meet any margin calls resulting from decreases in value related to a reasonably possible (in the opinion of management) widening of credit spreads. Funding a margin call on our credit facility would have a dilutive effect on our earnings, however we would not expect this to be material.

Fair Values

Fair values for a majority of our investments are readily obtainable through broker quotations. For certain of our financial instruments, fair values are not readily available since there are no active trading markets as characterized by current exchanges between willing parties. Accordingly, fair values can only be derived or estimated for these instruments using various valuation techniques, such as computing the present value of estimated future cash flows using discount rates commensurate with the risks involved. However, the determination of estimated future cash flows is inherently subjective and imprecise. We note that minor changes in assumptions or estimation methodologies can have a material effect on these derived or estimated fair values, and that the fair values reflected below are indicative of the interest rate and credit spread environments as of September 30, 2006 and do not take into consideration the effects of subsequent interest rate or credit spread fluctuations.

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

Interest Rate and Credit Spread Risk

We held the following interest rate and credit spread risk sensitive instruments at September 30, 2006 (unaudited) (dollars in thousands):

	Carrying Value	Principal Balance or Notional Amount	Weighted Average Yield/Funding Cost	Weighted Average Maturity	Fair Value
Assets:					
Real estate securities, available for sale (1)	\$ 5,369,641	\$ 5,392,628	6.61%	(1)	\$ 5,369,641
Real estate related loans (2)	1,238,418	1,240,531	8.74%	(2)	1,243,434
Residential mortgage loans (3)	863,788	869,115	7.99%	(3)	883,420
Subprime mortgage loans subject to future repurchase (4)	287,546	299,176	(4)	(4)	287,546
Interest rate caps, treated as hedges (5)	1,677	342,351	N/A	(5)	1,677
Total return swaps (6)	659	186,883	N/A	(6)	659
Liabilities:					
CBO bonds payable (7)	3,505,906	3,533,270	5.64%	(7)	3,563,789
Other bonds payable (8)	704,785	709,237	6.67%	(8)	705,531
Notes payable (9)	153,957	153,957	5.67%	(9)	153,957
Repurchase agreements (10)	2,197,780	2,197,780	5.48%	(10)	2,197,780
Financing of subprime mortgage loans subject to future repurchase (4)	287,546	299,176	(4)	(4)	287,546
Credit facility (11)	125,000	125,000	7.10%	(11)	125,000
Junior subordinated notes payable (12)	100,100	100,100	7.62%	(12)	101,672
Interest rate swaps, treated as hedges (13)	(37,139)	3,838,625	N/A	(13)	(37,139)
Non-hedge derivatives (14)	444	147,500	N/A	(14)	444

(1) These securities contain various terms, including fixed and floating rates, self-amortizing and interest only. Their weighted average maturity is 5.23 years. The fair value of these securities is estimated by obtaining third party broker quotations, if available and practicable, and counterparty quotations.

(2) Represents the following loans:

Loan Type	Current Face Amount	Carrying Value	Weighted Avg. Yield	Weighted Average Maturity (Years)	Floating Rate Loans as a % of Face Amount	Fair Value
B-Notes	\$ 95,859	\$ 95,124	7.25%	4.31	54.8%	\$ 97,815
Mezzanine Loans	729,701	729,509	8.90%	2.73	100.0%	730,632
Bank Loans	209,691	209,813	7.80%	4.25	100.0%	211,014
Whole Loans	74,993	75,238	11.94%	1.90	100.0%	75,239
ICH Loans	130,287	128,734	8.64%	1.24	1.5%	128,734
	<u>\$ 1,240,531</u>	<u>\$ 1,238,418</u>	<u>8.74%</u>	<u>2.90</u>	<u>86.2%</u>	<u>\$ 1,243,434</u>

The ICH loans were valued by discounting expected future cash flows by the loans' effective rate at acquisition. The rest of the loans were valued by obtaining third party broker quotations, if available and practicable, and counterparty quotations.

- (3) This aggregate portfolio of residential loans consists of a portfolio of floating rate residential mortgage loans, two portfolios of substantially fixed rate manufactured housing loans, and the \$195.2 million portfolio of residential mortgage loans has a weighted average maturity of 2.79 years. The \$674.0 million manufactured housing loan portfolios have a weighted average maturity of 6.05 years. The residential mortgage loans and manufactured housing loans were valued by reference to current market interest rates and credit spreads.
- (4) Thesetwo items, related to the securitization of subprime mortgage loans, are equal and offsetting. They each yield 9.24% and are further described under "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources".
- (5) Represents cap agreements as follows:

Notional Balance	Effective Date	Maturity Date	Capped Rate	Strike Rate	Fair Value
\$ 262,732	Current	March 2009	1-Month LIBOR	6.50%	\$ 59
18,000	January 2010	October 2015	3-Month LIBOR	8.00%	253
8,619	December 2010	June 2015	3-Month LIBOR	7.00%	492
53,000	May 2011	September 2015	1-Month LIBOR	7.50%	873
<u>\$ 342,351</u>					<u>\$ 1,677</u>

The fair value of these agreements is estimated by obtaining counterparty quotations.

- (6) Represents total rate of return swaps which are treated as non-hedge derivatives. The fair value of these agreements, which is included in Derivative Assets, is estimated by obtaining counterparty quotations. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources" for a further discussion of these swaps.
- (7) These bonds were valued by discounting expected future cash flows by a rate calculated based on current market conditions for comparable financial instruments, including market interest rates and credit spreads. The weighted average maturity of the CBO bonds payable is 5.80 years. The CBO bonds payable amortize principal prior to maturity based on collateral receipts, subject to reinvestment requirements.
- (8) The ICH bonds amortize principal prior to maturity based on collateral receipts and have a weighted average maturity of 1.05 years. These bonds were valued by discounting expected future cash flows by a rate calculated based on current market conditions for comparable financial instruments, including market interest rates and credit spreads. The manufactured housing loan bonds amortize principal prior to maturity based on collateral receipts and have a weighted average maturity of 2.78. These bonds were valued by reference to current market interest rates and credit spreads.
- (9) The residential mortgage loan financing has a weighted average maturity of 0.84 years and is subject to adjustment monthly based on the market value of the loan portfolio. This financing was valued by reference to current market interest rates and credit spreads.
- (10) These agreements bear floating rates of interest, which reset monthly or quarterly to a market credit spread, and we believe that, for similar financial instruments with comparable credit risks, the effective rates approximate market rates. Accordingly, the carrying amounts outstanding are believed to approximate fair value. These agreements have a weighted average maturity of 0.13 years.
- (11) The credit facility has a weighted average maturity of 1.09 years. This facility was valued at par because management believes it could currently enter a similar arrangement under similar terms.
- (12) These notes have a weighted average maturity of 29.5 years. These notes were valued by discounting expected future cash flows by a rate calculated based on current market conditions for comparable financial instruments, including market interest rates and credit spreads. The credit spread used was obtained from a broker quotation.

(13) Represents current swap agreements as follows:

Year of Maturity	Weighted Average Maturity	Aggregate Notional Amount	Weighted Average Fixed Pay Rate	Aggregate Fair Value
Agreements which receive 1-Month LIBOR:				
2009	May 2009	\$ 343,377*	3.28%	\$ (10,491)
2010	Jun 2010	425,626	4.37%	(6,460)
2011	May 2011	524,864	5.30%	3,647
2013	Jun 2013	14,057	5.28%	150
2014	Dec 2014	9,052	5.27%	108
2015	Jul 2015	784,627	4.92%	(7,532)
2016	Apr 2016	597,431	5.22%	3,796
2017	Apr 2017	8,745	5.33%	92
Agreements which receive 3-Month LIBOR:				
2011	Apr 2011	337,000	5.81%	8,694
2013	Mar 2013	295,140	3.97%	(15,148)
2014	Jun 2014	357,911	4.21%	(18,045)
2016	May 2016	140,795	5.55%	4,050
		\$ 3,838,625		\$ (37,139)

* \$262,732 of this notional receives 1-Month LIBOR only up to 6.50%

The fair value of these agreements is estimated by obtaining counterparty quotations. A positive fair value represents a liability. We have recorded \$60.7 million of gross interest rate swap assets and \$23.6 million of liabilities.

(14) These are two essentially offsetting interest rate caps and two essentially offsetting interest rate swaps, each with notional amounts of \$32.5 million and an interest rate cap with a notional balance of \$17.5 million. The maturity date of the purchased swap is July 2009; the maturity date of the sold swap is July 2014, the maturity date of the \$32.5 million caps is July 2038 and the maturity date of the \$17.5 million cap is July 2009. The fair value of these agreements is estimated by obtaining counterparty quotations. A positive fair value represents a liability; therefore, we have a net non-hedge derivative asset.

ITEM 4. CONTROLS AND PROCEDURES

- (a) Disclosure Controls and Procedures. The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this report. The Company's disclosure controls and procedures are designed to provide reasonable assurance that information is recorded, processed, summarized and reported accurately and on a timely basis. Based on such evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, the Company's disclosure controls and procedures are effective.
- (b) Internal Control Over Financial Reporting. There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The Company is not party to any material legal proceedings.

Item 1A. Risk Factors

There have been no material changes from the risk factors previously disclosed in the registrant's Form 10-K for the year ended December 31, 2005.

CAUTIONARY STATEMENTS

The information contained in this quarterly report on Form 10-Q is not a complete description of our business or the risks associated with an investment in our company. We urge you to carefully review and consider the various disclosures made by us in this report and in our other filings with the Securities and Exchange Commission ("SEC"), including our annual report on Form 10-K for the year ended December 31, 2005, that discuss our business in greater detail.

This report contains certain "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements relate to, among other things, the operating performance of our investments, the stability of our earnings, and our financing needs. Forward-looking statements are generally identifiable by use of forward-looking terminology such as "may," "will," "should," "potential," "intend," "expect," "endeavor," "seek," "anticipate," "estimate," "overestimate," "underestimate," "believe," "could," "project," "predict," "continue" or other similar words or expressions. Forward-looking statements are based on certain assumptions, discuss future expectations, describe future plans and strategies, contain projections of results of operations or of financial condition or state other forward-looking information. Our ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Although we believe that the expectations reflected in such forward-looking statements are based on reasonable assumptions, our actual results and performance could differ materially from those set forth in the forward-looking statements. These forward-looking statements involve risks, uncertainties and other factors that may cause our actual results in future periods to differ materially from forecasted results. Factors which could have a material adverse effect on our operations and future prospects include, but are not limited to, our ability to take advantage of opportunities in additional asset classes at attractive risk-adjusted prices, our ability to deploy capital accretively, the risks that default and recovery rates on our loan portfolios exceed our underwriting estimates, the relationship between yields on assets which are paid off and yields on assets in which such monies can be reinvested, the relative spreads between the yield on the assets we invest in and the cost of financing, changes in economic conditions generally and the real estate and bond markets specifically; adverse changes in the financing markets we access affecting our ability to finance our real estate securities portfolios in general or particular real estate related assets, or in a manner that maintains our historic net spreads; changes in interest rates and/or credit spreads, as well as the success of our hedging strategy in relation to such changes; the quality and size of the investment pipeline and the rate at which we can invest our cash, including cash inside our CBOs; impairments in the value of the collateral underlying our real estate securities, real estate related loans and residential mortgage loans and the relation of any such impairments to our judgments as to whether changes in the market value of our securities, loans or real estate are temporary or not and whether circumstances bearing on the value of such assets warrant changes in carrying values; legislative/regulatory changes; completion of pending investments; the availability and cost of capital for future investments; competition within the finance and real estate industries; and other risks detailed from time to time in our SEC reports. Readers are cautioned not to place undue reliance on any of these forward-looking statements, which reflect our management's views as of the date of this report. The factors noted above could cause our actual results to differ significantly from those contained in any forward-looking statement. For a discussion of our critical accounting policies, see "Management's Discussion and Analysis of Financial Condition and Results of Operations - Application of Critical Accounting Policies."

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. We are under no duty to update any of the forward-looking statements after the date of this report to conform these statements to actual results.

In addition, risks relating to our management and business, which are described in our SEC reports include, specifically, (1) the following risks relating to our management: (i) We are dependent on our manager and may not find a suitable replacement if our manager terminates the management agreement. Furthermore, we are dependent on the services of certain key employees of our manager and the loss of such services could temporarily adversely affect our operations; (ii) There are conflicts of interest inherent in our relationship with our manager insofar as our manager and its affiliates manage and invest in other pooled investment vehicles (investment funds, private investment funds, or businesses) that invest in real estate securities, real estate related loans and operating real estate and whose investment objectives overlap with our investment objectives. Our management agreement with our manager does not limit or restrict our manager or its affiliates from managing other investment vehicles that invest in investments which meet our investment objectives. Certain investments appropriate for Newcastle may also be appropriate for one or more of these other investment vehicles and our manager or its affiliates may determine to make a particular investment through another investment vehicle rather than through Newcastle. It is possible that

we may not be given the opportunity to participate at all in certain investments made by our affiliates that meet our investment objectives; and (iii) Our investment strategy may evolve, in light of existing market conditions and investment opportunities, to continue to take advantage of opportunistic investments in real estate related assets, which may involve additional risks depending upon the nature of such assets and our ability to finance such assets on a short or long term basis; and (2) the following risks relating to our business: (i) Although we seek to match fund our investments to limit refinance risk, in particular with respect to a substantial portion of our investments in real estate securities and loans, we do not employ this strategy with respect to certain of our investments, which increases refinance risks for and, therefore, the yield of these investments; (ii) We may not be able to match fund our investments with respect to maturities and interest rates, which exposes us to the risk that we may not be able to finance or refinance our investments on economically favorable terms; (iii) Prepayment rates can increase, adversely affecting yields on certain of our loans; (iv) The real estate related loans and other direct and indirect interests in pools of real estate properties or loans that we invest in may be subject to additional risks relating to the privately negotiated structure and terms of the transaction, which may result in losses to us; and (v) We finance certain of our investments with debt subject to margin calls based on a decrease in the value of such investments, which could adversely impact our liquidity.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 5. Other Information

None.

Item 6. Exhibits

- 3.1 Articles of Amendment and Restatement (incorporated by reference to the Registrant's Registration Statement on Form S-11 (File No. 333-90578), Exhibit 3.1).
- 3.2 Articles Supplementary Relating to the Series B Preferred Stock (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the period ended March 31, 2003, Exhibit 3.3).
- 3.3 Articles Supplementary Relating to the Series C Preferred Stock (incorporated by reference to the Registrant's Report on Form 8-K, Exhibit 3.3, filed on October 25, 2005).
- 3.4 Amended and Restated By-laws (incorporated by reference to the Registrant's Registration Statement on Form 8-K, Exhibit 3.1, filed on May 5, 2006).
- 4.1 Rights Agreement between the Registrant and American Stock Transfer and Trust Company, as Rights Agent, dated October 16, 2002 (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the period ended September 30, 2002, Exhibit 4.1).
- 10.1 Amended and Restated Management and Advisory Agreement by and among the Registrant and Fortress Investment Group LLC, dated June 23, 2003 (incorporated by reference to the Registrant's Registration Statement on Form S-11 (File No. 333-106135), Exhibit 10.1).
- 10.2 Newcastle Investment Corp. Nonqualified Stock Option and Incentive Award Plan Amended and Restated Effective as of February 11, 2004 (incorporated by reference to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2005, Exhibit 10.2).
- 31.1 Certification of Chief Executive Officer as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

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

NEWCASTLE INVESTMENT CORP.

(Registrant)

By: /s/ Wesley R. Edens

Name: Wesley R. Edens
Title: Chairman of the Board
Chief Executive Officer
Date: November 9, 2006

By: /s/ Debra A. Hess

Name: Debra A. Hess
Title: Chief Financial Officer
Date: November 9, 2006

EXHIBIT 31.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER

I, Wesley R. Edens, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Newcastle Investment Corp.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

November 9, 2006
(Date)

By: /s/ Wesley R. Edens

Wesley R. Edens
Chief Executive Officer
Title

EXHIBIT 31.2

CERTIFICATION OF CHIEF FINANCIAL OFFICER

I, Debra A. Hess, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Newcastle Investment Corp.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

November 9, 2006
(Date)

/s/ Debra A. Hess

Debra A. Hess
Chief Financial Officer

EXHIBIT 32.1

**CERTIFICATION OF CEO PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report on Form 10-Q of Newcastle Investment Corp. (the "Company") for the quarterly period ended September 30, 2006 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Wesley R. Edens, as Chief Executive Officer of the Company, hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of his knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Wesley R. Edens

Wesley R. Edens
Chief Executive Officer
November 9, 2006

This certification accompanies the Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not, except to the extent required by the Sarbanes-Oxley Act of 2002, be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.

A signed original of this written statement required by Section 906 of the Sarbanes-Oxley Act of 2002 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

EXHIBIT 32.2

CERTIFICATION OF CFO PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report on Form 10-Q of Newcastle Investment Corp. (the "Company") for the quarterly period ended September 30, 2006 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Debra A. Hess, as Chief Financial Officer of the Company, hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of her knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Debra A. Hess

Debra A. Hess
Chief Financial Officer
November 9, 2006

This certification accompanies the Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not, except to the extent required by the Sarbanes-Oxley Act of 2002, be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.

A signed original of this written statement required by Section 906 of the Sarbanes-Oxley Act of 2002 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

End of Filing
