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

FORM 10-K

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

For the fiscal year ended December 31, 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	81-0559116
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1345 Avenue of the Americas, New York, NY	10105
(Address of principal executive offices)	(Zip Code)

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

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

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

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

☒ Yes ☐ No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

☐ Yes ☒ No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

☒ Yes ☐ No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, 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). (Check One):

☐ Yes ☒ No

The aggregate market value of the voting common stock held by non-affiliates as of June 30, 2006 (computed based on the closing price on such date as reported on the NYSE) was: $1.0 billion.

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: 48,137,099 outstanding as of February 16, 2007.

DOCUMENTS INCORPORATED BY REFERENCE:

1. Portions of the Registrant’s definitive proxy statement for the Registrant’s 2007 annual meeting, to be filed within 120 days after the close of the Registrant’s fiscal year, are incorporated by reference into Part III of this Annual Report on Form 10-K.

CAUTIONARY STATEMENTS

This report contains certain "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements relate to, among other things, the operating performance of our investments, the stability of our earnings, and our financing needs. Forward-looking statements are generally identifiable by use of forward-looking terminology such as "may," "will," "should," "potential," "intend," "expect," "endeavor," "seek," "anticipate," "estimate," "overestimate," "underestimate," "believe," "could," "project," "predict," "continue" or other similar words or expressions. Forward-looking statements are based on certain assumptions, discuss future expectations, describe future plans and strategies, contain projections of results of operations or of financial condition or state other forward-looking information. Our ability to predict results or the actual 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 investments, 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 investments and the relation of any such impairments to our judgments as to whether changes in the market value of our securities, loans or real estate are temporary or not and whether circumstances bearing on the value of such assets warrant changes in carrying values; legislative/regulatory changes; 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 below and in our other 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.

NEWCASTLE INVESTMENT CORP.
FORM 10-K

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PART I

Item 1. Business.

Overview

Newcastle Investment Corp. ("Newcastle") is a real estate investment and finance company. We invest with the objective of producing long term, stable returns under varying interest rate and credit cycles, with a moderate amount of credit risk. Newcastle invests 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, when appropriate, which reduces our interest rate and financing risks. We make money by optimizing our "net spread," the difference between the yield on our investments and the cost of financing these investments. We emphasize asset quality, diversification, match funded financing and credit risk management.

Our investment activities cover four distinct categories:

1) Real Estate Securities:	We underwrite and acquire a diversified portfolio of moderately credit sensitive real estate securities, including commercial mortgage backed securities (CMBS), senior unsecured REIT debt issued by property REITs, real estate related asset backed securities (ABS) and agency residential mortgage backed securities (RMBS). We generally target investments rated A through BB, except for our agency RMBS which are generally considered AAA rated. As of December 31, 2006, our investments in real estate securities represented 74.6% of our assets.
2) Real Estate Related Loans:	We acquire and originate loans to well capitalized real estate owners with strong track records and compelling business plans, including B-notes, mezzanine loans, bank loans, and real estate loans. As of December 31, 2006, our investments in real estate related loans represented 11.0% of our assets.
3) Residential Mortgage Loans:	We acquire residential mortgage loans, including manufactured housing loans and subprime mortgage loans, that we believe will produce attractive risk-adjusted returns. As of December 31, 2006, our investments in residential mortgage loans represented 13.7% of our assets.
4) Operating Real Estate:	We acquire direct and indirect interests in operating real estate. As of December 31, 2006, our investments in operating real estate represented 0.6% of our assets.

In addition, Newcastle had uninvested cash and other miscellaneous net assets which represented 0.1% of our assets at December 31, 2006.

Underpinning our investment activities is a disciplined approach to acquiring, financing and actively managing our assets. Our principal objective is to acquire a highly diversified portfolio of debt investments secured by real estate that has moderate credit risk and sufficient liquidity. Newcastle primarily utilizes a match funded financing strategy, when appropriate, in order to minimize refinancing and interest rate risks. This means that we seek both to match the maturities of our debt obligations with the maturities of our investments, in order to minimize the risk that we have to refinance our liabilities prior to the maturities of our assets, and to match the interest rates on our investments with like-kind debt (i.e. floating or fixed), in order to reduce the impact of changing interest rates on our earnings. Finally, we actively manage credit exposure through portfolio diversification and ongoing asset selection and surveillance. Newcastle, through its manager, has a dedicated team of senior investment professionals experienced in real estate capital markets, structured finance and asset management. We believe that these critical skills position us well not only to make prudent investment decisions but also to monitor and manage the credit profile of our investments.

Newcastle's stock is traded on the New York Stock Exchange under the symbol "NCT". Newcastle is a real estate investment trust for federal income tax purposes and is externally managed and advised by an affiliate of Fortress Investment Group LLC, or Fortress. Fortress is a global alternative investment and asset management firm with over $30 billion in assets under management as of December 31, 2006. Fortress, which was founded in 1998, became the first global alternative asset manager listed on the New York Stock Exchange (NYSE: FIG) in February 2007. We believe that our manager's expertise and significant business relationships with participants in the fixed income, structured finance and real estate industries has enhanced our access to investment opportunities which may not be broadly marketed. For its services, our manager receives a management fee and incentive compensation pursuant to a management agreement. Our manager, through its affiliates, and principals of Fortress owned 2.9 million shares of our common stock and our manager, through its affiliates, had options to purchase an additional 1.4 million shares of our common stock, which were issued in connection with our equity offerings, representing approximately 8.7% of our common stock on a fully diluted basis, as of February 16, 2007.

Our Strategy

Newcastle's investment strategy focuses predominantly on debt investments secured by real estate. We do not have specific policies as to the allocation among type of real estate related assets or investment categories since our investment decisions depend on changing market conditions. Instead, we focus on relative value and in-depth risk/reward analysis with an emphasis on asset quality, liquidity and diversification. Our focus on relative value means that assets which may be unattractive under particular market conditions may, if priced appropriately to compensate for risks such as projected defaults and prepayments, become attractive relative to other available investments. We utilize a match funded financing strategy, when appropriate, and active credit risk management to optimize our returns.

The following table summarizes our investment portfolio at December 31, 2006 and December 31, 2005:

	December 31, 2006		December 31, 2005	
	Face Amount	% Total	Face Amount	% Total
Real Estate Securities and Related Loans	$ 6,196,179	71.7%	$ 4,802,172	76.1%
Agency RMBS	1,177,779	13.6%	697,530	11.0%
Total Real Estate Securities and Related Loans	7,373,958	85.3%	5,499,702	87.1%
Residential Mortgage Loans	812,561	9.4%	610,970	9.7%
Other				
Subprime Loans Subject to Future Repurchase	299,176	3.5%	-	0.0%
Investment in Joint Venture	38,469	0.4%	38,164	0.6%
ICH Loans	123,390	1.4%	165,514	2.6%
Total Portfolio	$ 8,647,554	100.0%	$ 6,314,350	100.0%

The table excludes operating real estate of $33.8 million at December 31, 2006 and $20.2 million at December 31, 2005.

Asset Quality and Diversification at December 31, 2006

Total real estate securities and related loans of $7.4 billion face amount, representing 85.3% of the total portfolio

Asset Quality

- $6.0 billion or 81.5% of this portfolio is rated by third parties, or had an implied AAA rating, with a weighted average rating of BBB+.
- $1.4 billion or 18.5% of this portfolio is not rated by third parties but had a weighted average loan to value ratio of 68.6%.
- 63% of this portfolio has an investment grade rating (BBB- or higher).
- The weighted average credit spread (i.e., the yield premium on our investments over the comparable US Treasury or LIBOR) for the core real estate securities and related loans of $6.2 billion (excluding agency RMBS) was 2.56%.

Diversity

- Our real estate securities and loans are diversified by asset type, industry, location and issuer.
- This portfolio had 635 investments. The largest investment was $179.5 million and the average investment size was $11.6 million.
- Our real estate securities are supported by pools of underlying loans. For instance, our CMBS investments had over 21,000 underlying loans.

Residential mortgage loans of $0.8 billion face amount, representing 9.4% of the total portfolio

Asset Quality

- These residential loans are to high quality borrowers with an average Fair Isaac Corp. credit score ("FICO") of 697.
- Approximately $142.3 million face amount were held in securitized form, of which 95.7% was rated investment grade.

Diversity

- Our residential and manufactured housing loans were well diversified with 491 and 18,343 loans, respectively.

Financing Strategy and Match Funded Discipline

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 December 31, 2006, our debt to equity ratio was approximately 7.5 to 1. On a pro forma basis, our debt to equity ratio would have been 6.7 to 1 if the trust preferred securities we issued in March 2006 were considered equity for purposes of this computation. Also, on a pro forma basis, our debt to equity ratio would have been 6.9 to 1 after adjustment for the common stock issued in January 2007. We utilize leverage for the sole purpose of financing our portfolio and not for the purpose of speculating on changes in interest rates.

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), which represent 57% of our debt obligations, other securitizations, term loans (including total rate of return swaps), a credit facility and trust preferred securities, as well as short term financing in the form of repurchase agreements and asset backed commercial paper.

Our manager may elect for us to bear a level of refinancing risk on a short term or longer term basis, such as is the case with investments financed with repurchase agreements or asset backed commercial paper (ABCP), when based on all of the relevant factors, bearing such risk is advisable. As of December 31, 2006, approximately 25% of our debt obligations were in the form of repurchase agreements including repurchase agreements subject to ABCP.

We attempt to reduce interim refinancing risk and to minimize exposure to interest rate fluctuations through the use of match funded financing structures, when appropriate, whereby we seek (i) to match the maturities of our debt obligations with the maturities of our assets and (ii) to match the interest rates on our investments with like-kind debt (*i.e.*, floating rate assets are financed with floating rate debt and fixed rate assets are financed with fixed rate debt), directly or through the use of interest rate swaps, caps or other financial instruments, or through a combination of these strategies. This allows us 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. As of December 31, 2006, a 100 basis point change in short term interest rates would impact our earnings by approximately $0.2 million per annum.

Credit Risk Management

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 our investments offer attractive risk-adjusted returns with long term principal protection under a variety of default and loss scenarios. We minimize credit risk by actively monitoring our investments, their underlying credit quality, loan to value ratio and, where appropriate, repositioning our investments to upgrade their credit quality and yield. A significant portion of our investments are financed with collateralized bond obligations, known as CBOs. Our CBO financings offer us structural flexibility to buy and sell certain investments to manage risk and, subject to certain limitations, to optimize returns.

Further, the expected yield on our real estate securities, which comprise a significant portion of our assets, is sensitive to the performance of the underlying loans, the first risk of default and loss is borne by the more subordinated securities or other features of the securitization transaction, in the case of commercial mortgage and asset backed securities, and the issuer’s underlying equity and subordinated debt, in the case of senior unsecured REIT debt securities.

Formation

We were formed in June 2002 as a subsidiary of Newcastle Investment Holdings Corp. Prior to our initial public offering, Newcastle Investment Holdings contributed to us certain assets and related liabilities in exchange for approximately 16.5 million shares of our common stock. For accounting purposes, this transaction is presented as a reverse spin-off, whereby Newcastle Investment Corp. is treated as the continuing entity and the assets that were retained by Newcastle Investment Holdings and not contributed to us are accounted for as if they were distributed at their historical book basis through a spin-off to Newcastle Investment Holdings. Our operations commenced in July 2002. In May 2003, Newcastle Investment Holdings distributed to its stockholders all of the shares of our common stock that it owned, and it no longer owns any of our equity.

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

Year	Shares Issued	Range of Issue Prices per Share (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
2006	1,800,408	$29.42	$ 51.2
December 31, 2006	45,713,817		
January 2007	2,420,000	$31.30	$ 75.0

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

Our Investing Activities

Information regarding our business segments is provided in “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and in Note 3 to our consolidated financial statements which appear in “Financial Statements and Supplementary Data.”

The following is a description of our investments as of December 31, 2006.

Real Estate Securities

We own a diversified portfolio of moderately credit sensitive real estate securities, which was comprised of the following at December 31, 2006 (dollars in thousands):

				Weighted Average		
Asset Type	Current Face Amount	Carrying Value	Number of Securities	S&P Equivalent Rating	Yield	Maturity (Years)
CMBS-Conduit	$ 1,469,298	$ 1,452,789	202	BBB	6.51%	6.93
CMBS-Large Loan	714,617	719,225	53	BBB-	7.02%	2.62
CMBS-CDO	23,500	21,958	2	BB	12.03%	7.68
CMBS- B-Note	282,677	276,190	41	BB	7.51%	6.02
Unsecured REIT Debt	1,004,540	1,025,040	101	BBB-	6.06%	6.17
ABS-Manufactured Housing	80,839	77,700	9	BBB-	7.79%	6.54
ABS-Home Equity	729,292	710,331	124	BBB+	7.89%	2.70
ABS-Franchise	76,777	76,707	22	BBB	8.21%	4.80
Agency RMBS	1,177,779	1,176,358	35	AAA	5.19%	4.27
Subtotal/Average (A)	5,559,319	5,536,298	589	BBB+	6.50%	5.04
Residual interest (B)	44,930	44,930	1	NR	18.77%	2.52
Total/Average	$ 5,604,249	$ 5,581,228	590	BBB+	6.60%	5.02

(A) Implied AAA rating.
(B) Represents the retained equity from securitization of subprime mortgage loans as described in "Residential Mortgage Loans" below.

The loans underlying our real estate securities were diversified by industry as follows at December 31, 2006:

Industry	% of Face Amount
Residential	29.50%
Retail	16.22%
Office	15.02%
Subprime Residential	13.81%
Lodging	6.57%
Industrial	2.00%
Health Care	1.81%
Other	15.07%

Real Estate Related Loans

We directly owned the following real estate related loans at December 31, 2006 (dollars in thousands):

Loan Type	Current Face Amount	Carrying Value	Loan Count	Weighted Avg. Yield	Weighted Avg. Maturity (Years)
B-Notes	$ 248,240	$ 246,798	9	7.98%	2.71
Mezzanine Loans (1)	906,907	904,686	22	8.61%	2.67
Bank Loans	233,793	233,895	6	7.75%	3.92
Whole Loans	61,240	61,703	3	12.63%	1.81
ICH Loans	123,390	121,834	70	7.77%	1.10
Total	$ 1,573,570	$ 1,568,916	110	8.48%	2.71

(1) One of these loans has an $8.9 million contractual exit fee. Newcastle will begin to accrue this fee if and when management believes it is probable that such exit fee will be received.

We also indirectly owned the following interests in real estate related loans at December 31, 2006:

Joint Venture

In 2003, we co-invested, on equal terms, in a joint venture alongside an affiliate of our manager which acquired a pool of franchise loans collateralized by fee and leasehold interests and other assets. We, and our manager's affiliate, each own an approximately 38% interest in the joint venture. The remaining approximately 24% interest is owned by a third party financial institution. Our investment totaled $10.2 million at December 31, 2006 and is reflected as an investment in an unconsolidated subsidiary on our consolidated balance sheet.

Our relative interest in these franchise loans is summarized as follows (dollars in thousands):

Current Face Amount	Carrying Value	Loan Count	Weighted Avg. Yield
$ 19,878	$ 10,249	57	15.30%

Loans Financed via Total Rate of Return Swaps

We have entered into total rate of return swaps with major investment banks 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 through income. 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 (recorded in Restricted Cash), less any negative change in value amounts, will be returned to us upon termination of the contract.

As of December 31, 2006, Newcastle held an aggregate of $299.7 million notional amount of total rate of return swaps on 8 reference assets on which it had deposited $46.8 million of margin. These total rate of return swaps had an aggregate fair value of approximately $1.3 million, a weighted average receive interest rate of LIBOR + 2.59%, a weighted average pay interest rate of LIBOR + 0.63%, and a weighted average swap maturity of 1.5 years.

Residential Mortgage Loans

We own portfolios of residential mortgage loans, including manufactured housing loans and subprime mortgage loans, on properties located in the U.S. The following table sets forth certain information with respect to our residential mortgage loan portfolios at December 31, 2006 (dollars in thousands):

Loan Type	Current Face Amount	Carrying Value	Loan Count	Weighted Avg. Yield (1)	Weighted Avg. Maturity (Years) (2)
Residential loans	$ 168,649	$ 172,839	491	6.42%	2.79
Manufactured housing loans	643,912	636,258	18,343	8.48%	6.02
Total	$ 812,561	$ 809,097	18,834	8.03%	5.35
Subprime mortgage loans subject to future repurchase	$ 299,176	$ 288,202			

(1) Loss adjusted.
(2) Weighted average maturity was calculated based on a constant prepayment rate (CPR) of approximately 30% for residential loans and 9% for manufactured housing loans.

In March 2006, we 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 Nationstar Mortgage, LLC (formerly known as 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 with respect 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%. 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 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, through Newcastle Mortgage Securities Trust 2006-1 (the "Securitization Trust"), we closed on a securitization of the Subprime Portfolio. The Securitization Trust is not consolidated by us. We 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"). We 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. As holder of the equity of the Securitization Trust, we 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, resulting in a net gain of approximately $40,000 being recorded in April 2006. 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. This 20% portion of the loans which is subject to future repurchase by us was not treated as being sold and is classified as "held for investment" subsequent to the completion of the securitization. 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, 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.

Operating Real Estate

The following table sets forth certain information with respect to our operating real estate as of December 31, 2006 (dollars, others than per square foot amounts, in thousands):

Property Address	Use	Net Rentable Sq Ft	Major tenants	% of Total Sq Ft Leased	Tenant Net Rentable Sq Ft	Annual Rent
100 Dundas St. (1) (3) London, ON	Office	312,874	Bell Canada (2)	59.1%	184,829	$ 1,294
			A total of 4 tenants	1.5%	4,668	26
				60.6%	189,497	1,320
Apple Valley I 1430 Oak Court Beavercreek, OH	Office	54,927	A total of 8 tenants	65.0%	35,702	504
Apple Valley II 4020 Executive Drive Beavercreek, OH	Office	29,916	1 tenant	100.0%	29,916	478
Apple Valley III 4021-29 Executive Drive Beavercreek, OH	Office	45,299	1 tenant	77.0%	34,878	558
Dayton Towne Center 1880 Needmore Drive Dayton, OH	Retail	33,485	A total of 5 tenants	75.2%	25,197	153
Airport Corporate Center 303 Corporate Center Dr Vandalia, OH	Office	46,614	A total of 7 tenants	50.3%	23,468	301
2 River Place Dayton, OH	Office	42,286	Vacant	0.0%	-	-
Totals		565,401		59.9%	338,658	$ 3,314

(1) Monetary amounts for the Canadian property are in U.S. dollars based on December 31, 2006 Canadian dollar exchange ratio of 1.1659.
(2) This lease charges an administration fee of up to 15% of the operating expenses reimbursable by the tenant.
(3) The parking garage income for approximately 185 parking stalls is not included in the annual rent.

Schedule of lease expirations (dollars in thousands):

Year	Square Feet of Expiring Leases	Annual Rent of Expiring Leases (1)	% of Gross Annual Rent represented by Expiring Leases
2007	68,918	$ 885	26.7%
2008	23,828	336	10.1%
2009	8,528	113	3.4%
2010	15,103	136	4.2%
2011	30,964	495	14.9%
2012	191,317	1,349	40.7%
Leased total	338,658	$ 3,314	100.0%
Vacant	226,743		
Total	565,401		

We also indirectly owned the following interest in operating real estate at December 31, 2006:

Joint Venture

In March 2004, we purchased a 49% interest in a portfolio of convenience and retail gas stores located throughout the southeastern and southwestern regions of the U.S. The properties are subject to a sale-leaseback arrangement under long term triple net leases with a 15 year minimum term. Circle K Stores Inc. ("Tenant"), an indirect wholly owned subsidiary of Alimentation Couche-Tard Inc. ("ACT"), is the counterparty under the leases. ACT guarantees the obligations of Tenant under the leases. We structured this transaction through a joint venture in two limited liability companies with a private investment fund managed by an affiliate of our manager, pursuant to which it co-invested on equal terms. One company held assets available for sale, the last of which was sold in September 2005, and one holds assets for investment. In October 2004, the investment's initial financing was refinanced with a non-recourse term loan ($52.9 million outstanding at December 31, 2006), which bears interest at a fixed rate of 6.04%. The required payments under the loan consist of interest only during the first two years, followed by a 25-year amortization schedule with a balloon payment due in October 2014. At December 31, 2006, we had a $12.5 million investment in this entity.

Our Financing and Hedging Activities

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 December 31, 2006, our debt to equity ratio was approximately 7.5 to 1. On a pro forma basis, our debt to equity ratio would have been 6.7 to 1 if the trust preferred securities we issued in March 2006 were considered equity for purposes of this computation. Also, on a pro forma basis, our debt to equity ratio would have been 6.9 to 1 after adjustment for the common stock issued in January 2007. We utilize leverage for the sole purpose of financing our portfolio and not for the purpose of speculating on changes in interest rates.

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 (including total rate of return swaps), a credit facility and trust preferred securities, as well as short term financing in the form of repurchase agreements and asset backed commercial paper.

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

We attempt to reduce interim refinancing risk and to minimize exposure to interest rate fluctuations through the use of match funded financing structures, when appropriate, whereby we seek (i) to match the maturities of our debt obligations with the maturities of our assets and (ii) to match the interest rates on our investments with like-kind debt (*i.e.*, floating rate assets are financed with floating rate debt and fixed rate assets are financed with fixed rate debt), directly or through the use of interest rate swaps, caps or other financial instruments, or through a combination of these strategies. This allows us 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.

We enter into hedging transactions to protect our positions from interest rate fluctuations and other changes in market conditions. These transactions may include interest rate swaps, the purchase or sale of interest rate collars, caps or floors, options, mortgage derivatives and other hedging instruments. These instruments may be used to hedge as much of the interest rate risk as our manager determines is in the best interest of our stockholders, given the cost of such hedges and the need to maintain our status as a REIT. Our manager elects to have us bear a level of interest rate risk that could otherwise be hedged when our manager believes, based on all relevant facts, that bearing such risks is advisable. We have extensive experience in hedging with these types of instruments. We engage in hedging for the purpose of protecting against interest rate risk and not for the purpose of speculating on changes in interest rates.

Further details regarding our hedging activities are presented in "Quantitative and Qualitative Disclosures About Market Risk-Fair Value."

Debt Obligations

The following table presents certain summary information regarding our debt obligations and related hedges as of December 31, 2006 (unaudited) (dollars in thousands):

Debt Obligation	Current Face Amount	Carrying Value	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	$ 4,340,166	$ 4,313,824	5.73%	5.83	$ 4,047,216	$ 4,944,086	5.05	$ 1,724,873	$ 2,168,565
Other Bonds Payable	679,891	675,844	6.63%	2.26	579,952	758,092	5.23	80,936	575,083
Notes Payable	128,866	128,866	5.68%	0.74	128,866	145,819	2.79	142,301	-
Repurchase Agreements	760,346	760,346	5.92%	0.08	760,346	953,383	2.77	823,901	112,087
Repurchase Agreements subject to ABCP	1,143,749	1,143,749	4.97%	0.08	1,143,749	1,176,358	4.27	-	1,087,385
Credit Facility	93,800	93,800	7.08%	0.85	93,800	-	-	-	-
Junior Subordinated Notes Payable	100,100	100,100	7.72%	29.25	-	-	-	-	-
Subtotal debt obligations	$ 7,246,918	$ 7,216,529	5.76%	4.15	$ 6,753,929	$ 7,977,738	4.63	$ 2,772,011	$ 3,943,120
Financing on Subprime Mortgage Loans Subject to Future Repurchase	299,176	288,202							
Total debt obligations	$ 7,546,094	$ 7,504,731							

(1) Including the effect of applicable hedges.

Further details regarding our debt obligations are presented in "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources."

Investment Guidelines

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

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

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

The Management Agreement

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

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

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

To provide an incentive for our manager to enhance the value of our common stock, our manager is entitled to receive an incentive return (the "Incentive Compensation") on a cumulative, but not compounding, basis in an amount equal to the product of (A) 25% of the dollar amount by which (1) (a) our funds from operations, as defined in the management agreement (before the Incentive Compensation) per share of common stock (based on the weighted average number of shares of common stock outstanding) plus (b) gains (or losses) from debt restructuring and from sales of property and other assets per share of common stock (based on the weighted average number of shares of common stock outstanding), exceed (2) an amount equal to (a) the weighted average of the price per share of common stock in our initial public offering and the value attributed to the net assets transferred to us by Newcastle Investment Holdings, and in any of our subsequent offerings (adjusted for prior capital dividends or capital distributions) multiplied by (b) a simple interest rate of 10% per annum (divided by four to adjust for quarterly calculations) multiplied by (B) the weighted average number of shares of common stock outstanding.

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

Policies With Respect to Certain Other Activities

We have authority to offer our common stock or other equity or debt securities in exchange for property and to repurchase or otherwise reacquire our shares or any other securities and may engage in such activities in the future.

We also may make loans to, or provide guarantees of, our subsidiaries. Although we have no current intentions of doing so, we may repurchase or otherwise reacquire our shares or other securities.

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

We may engage in the purchase and sale of investments. We do not underwrite the securities of other issuers.

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

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

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

We have financed our assets with the net proceeds of our initial public offering, follow-on offerings, the issuance of preferred stock, long term secured and unsecured borrowings, a credit facility and short term borrowings under repurchase agreements and asset backed commercial paper. In the future, operations may be financed by future offerings of equity securities, as well as short term and long term unsecured and secured borrowings. We expect that, in general, we will employ leverage consistent with the type of assets acquired and the desired level of risk in various investment environments. Our governing documents do not explicitly limit the amount of leverage that we may employ. Instead, the general investment guidelines adopted by our board of directors limits total leverage to a maximum 9.0 to 1 debt to equity ratio. At December 31, 2006, 2005 and 2004, our debt to equity ratio was approximately 7.5 to 1, 5.7 to 1, and 5.0 to 1, respectively. Our policy relating to the maximum leverage we may utilize may be changed by our board of directors at any time in the future.

Competition

We are subject to significant competition in seeking investments. We compete with several other companies for investments, including other REITs, insurance companies and other investors. Some of our competitors have greater resources than we do and we may not be able to compete successfully for investments.

Compliance with Applicable Environmental Laws

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

Employees

We are party to a management agreement with FIG LLC, an affiliate of Fortress Investment Group LLC, pursuant to which they advise us regarding investments, risk management, and other aspects of our business, and manage our day-to-day operations. As a result, we have no employees. From time to time, certain of our officers may enter into written agreements with us that memorialize the provision of certain services; these agreements do not provide for the payment of any cash compensation to such officers from us. The employees of FIG LLC are not a party to any collective bargaining agreement.

Corporate Governance and Internet Address

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

Our internet address is http://www.newcastleinv.com. We make available, free of charge through a link on our site, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to such reports, if any, as filed with the SEC as soon as reasonably practicable after such filing.

Our site also contains our code of business conduct and ethics, senior officer code of ethics, corporate governance guidelines, and the charters of the audit committee, nominating and corporate governance committee and compensation committee of our board of directors.

Item 1A. Risk Factors

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

Risks Relating to Our Management

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

We have no paid employees. Our officers are employees of our manager. We have no separate facilities and are completely reliant on our manager, which has significant discretion as to the implementation of our operating policies and strategies. We are subject to the risk that our manager will terminate the management agreement and that no suitable replacement will be found to manage us. Furthermore, we are dependent on the services of certain key employees of our manager whose continued service is not guaranteed, and the loss of such services could temporarily adversely affect our operations.

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

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

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

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

The ability of our manager and its officers and employees to engage in other business activities, subject to the terms of our management agreement with our manager, may reduce the time our manager spends managing Newcastle. In addition, we may engage in material transactions with our manager or another entity managed by our manager or one of its affiliates, including certain co-investments which present a conflict of interest, subject to our investment guidelines.

The management compensation structure that we have agreed to with our manager may cause our manager to invest in high risk investments. In addition to its management fee, our manager is entitled to receive incentive compensation based in part upon our achievement of targeted levels of funds from operations. In evaluating investments and other management strategies, the opportunity to earn incentive compensation based on funds from operations may lead our manager to place undue emphasis on the maximization of funds from operations at the expense of other criteria, such as preservation of capital, in order to achieve higher incentive compensation. Investments with higher yield potential are generally riskier or more speculative. This could result in increased risk to the value of our investment portfolio.

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

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

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

We may change our investment strategy without stockholder consent which may result in riskier investments than our current investments.

Decisions to make investments in entirely new asset categories present risks which may be difficult for us to adequately assess and could therefore reduce the stability of our dividends or have adverse effects on our financial condition. A change in our investment strategy may increase our exposure to interest rate and real estate market fluctuations.

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 and 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. Investment opportunities that present unattractive risk-return profiles relative to other available investment opportunities under particular market conditions may become relatively attractive under changed market conditions and changes in market conditions may therefore result in changes in the investments we target. Our failure to accurately assess the risks inherent in new asset categories or the financing risks associated with such assets could adversely affect our results of operations and our financial condition.

Risks Relating to Our Business

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

We are subject to significant competition in seeking investments. We compete with other companies, including other REITs, insurance companies and other investors, including funds and companies affiliated with our manager. Some of our competitors have greater resources than us and we may not be able to compete successfully for investments. Furthermore, competition for investments of the type to be made by us may lead to the returns available from such investments decreasing which may further limit our ability to generate our desired returns. We cannot assure you that other companies will not be formed that compete with us for investments or otherwise pursue investment strategies similar to ours.

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

We leverage our portfolio through borrowings, generally through the use of credit facilities, warehouse facilities, repurchase agreements, mortgage loans on real estate, securitizations, including the issuance of CBOs, private or public offerings of debt by subsidiaries, loans to entities in which we hold, directly or indirectly, interests in pools of properties or loans, and other borrowings. Our investment policies do not limit the amount of leverage we may incur with respect to any specific asset or pool of assets, subject to an overall limit on our use of leverage to 90% of the value of our assets on an aggregate basis. Our return on our investments and cash available for distribution to our stockholders may be reduced to the extent that changes in market conditions cause the cost of our financing to increase relative to the income that can be derived from the assets acquired.

We finance certain of our investments with debt (e.g., repurchase agreements) that is subject to margin calls based on a decrease in the value of such investments, which could adversely impact our liquidity and, as a result of the need to post greater margin with respect to existing investments, our return on equity. If we do not have the funds available to or choose not to satisfy any such margin calls, we could be forced to sell the investments at a loss.

Although we seek to match fund our investments to limit refinance risk and lock in net spreads, we do not employ this strategy with respect to certain of our investments, which increases the risks related to refinancing these investments.

A key to our investment strategy is to finance our investments using match funded financing structures, which match assets and liabilities with respect to maturities and interest rates. This limits our refinance risk, including the risk of being able to refinance an investment or refinance on favorable terms. We generally use match funded financing structures, such as CBOs, to finance our investments in real estate securities and loans. However, our manager may elect for us to bear a level of refinancing risk on a short term or longer term basis, such as is the case with investments financed with repurchase agreements or asset backed commercial paper, when, based on all of the relevant factors, bearing such risk is advisable. This is generally the case with respect to the residential mortgage loans and agency RMBS we invest in. The decision not to match fund certain investments exposes us to additional refinancing risks that may not apply to our other investments.

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

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

The loans we invest in and the loans underlying the securities and total rate of return swaps we invest in are subject to delinquency, foreclosure and loss, which could result in losses to us.

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

Residential mortgage loans, manufactured housing loans and subprime mortgage loans are secured by single-family residential property and are subject to risks of delinquency and foreclosure, and risks of loss. The ability of a borrower to repay a loan secured by a residential property is dependent upon the income or assets of the borrower. A number of factors may impair borrowers' abilities to repay their loans.

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

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

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

Subprime mortgage loans are generally loans to credit impaired borrowers and borrowers that are ineligible to qualify for loans from conventional mortgage sources due to loan size, credit characteristics or documentation standards. Loans to lower credit grade borrowers generally experience higher-than-average default and loss rates than do conforming mortgage loans. Material differences in the defaults, loss severities and/or prepayments on the subprime mortgage loans we acquire (or on the manufactured housing loans we acquire) from what we estimate in connection with our underwriting of the acquisition of such loans would cause reductions in our income and adversely affect our operating results, both with respect to unsecuritized loans and loans that we have securitized or otherwise financed on a long term match funded basis. We cannot assure you that our underwriting criteria will afford adequate protection against the higher risks associated with loans made to lower credit grade borrowers. If we underestimate the extent of losses that our loans will incur, then our business, financial condition, liquidity and results of operations will be adversely impacted.

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

When we acquire a portfolio of securities and loans which we finance on a short term basis with a view to securitization or other long term financing, we bear the risk of being unable to securitize the assets or otherwise finance them on a long term basis at attractive prices or in a timely matter, or at all. If it is not possible or economical for us to securitize or otherwise finance such assets on a long term basis, we may be unable to pay down our short term credit facilities, or be required to liquidate the assets at a loss in order to do so.

Both during the ramp up phase of a potential CBO financing and following the closing of a CBO financing when we have locked in the liability costs for a CBO during the reinvestment period, the rate at which we are able to acquire eligible investments and changes in market conditions may adversely affect our anticipated returns.

We acquire real estate securities and loans and finance them on a long term basis, typically through the issuance of collateralized bond obligations. We use short term warehouse lines of credit to finance the acquisition of real estate securities and loans until a sufficient quantity of assets are accumulated, at which time we may refinance these lines through a securitization, such as a CBO financing, or other long term financing. As a result, we are subject to the risk that we will not be able to acquire, during the period that our warehouse facility is available, a sufficient amount of eligible assets to maximize the efficiency of a collateralized bond obligation financing. In addition, conditions in the capital markets may make the issuance of a collateralized bond obligation less attractive to us when we do have a sufficient pool of collateral. If we are unable to issue a collateralized bond obligation to finance these assets, we may be required to seek other forms of potentially less attractive financing or otherwise to liquidate the assets.

In addition, following each CBO financing we must invest both the net cash raised in the financing as well as cash proceeds of any prepayment or assets which we determine to sell. Until we are able to acquire sufficient assets, our returns will reflect income earned on uninvested cash and, having locked in the cost of liabilities for the particular CBO, the particular CBO's returns will be at risk of declining to the extent that yields on the assets to be acquired decline.

In general, our ability to acquire appropriate investments depends upon the supply in the market of investments we deem suitable, and changes in various economic factors may affect our determination of what constitutes a suitable investment.

Our returns will be adversely affected when investment held in CBOs are prepaid or sold subsequent to the reinvestment period.

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

Our investments may be subject to impairment charges.

We will periodically evaluate our investments for impairment indicators. The judgment regarding the existence of impairment indicators is based on a variety of factors depending upon the nature of the investment and the manner in which the income related to such investment calculated for purposes of our financial statements. If we determine that a significant impairment has occurred, we would be required to make an adjustment to the net carrying value of the investment, which could adversely affect our results of operations and funds from operations in the applicable period.

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

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

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

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

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

We invest in real estate related loans and other direct and indirect interests in pools of real estate properties or loans.

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

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

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

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

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

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

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

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

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

Our assets are valued based primarily on third party quotations which are subject to significant variability based on market conditions. Certain of our investments, however, are highly illiquid and we will not have access to readily ascertainable market prices when establishing valuations of them. While we will endeavor to determine and establish valuations of our investments based on our manager's estimate of the fair market value of such investments, if we are required to liquidate all or a portion of our illiquid investments quickly, we may realize significantly less than the amount at which we have previously valued these investments.

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

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

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

Our ability to execute our business strategy, particularly the growth of our investment portfolio, depends to a significant degree on our ability to obtain additional capital. Our financing strategy is dependent on our ability to place the match funded debt we use to finance our investments at rates that provide a positive net spread. If spreads for such liabilities widen or if demand for such liabilities ceases to exist, then our ability to execute future financings will be severely restricted.

Interest rate changes may also impact our net book value as our real estate securities 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, which will decrease the book value of our equity.

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 interest rates generally.

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

Real estate securities are subject to changes in credit spreads. Fixed rate securities are valued based on a market credit spread over the rate payable on fixed rate U.S. Treasuries of like maturity. The value of these securities is dependent on the yield demanded on these securities by the market based on their credit relative to U.S. Treasuries. Excessive supply of these securities combined with reduced demand will generally cause the market to require a higher yield on these 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.

Our loan portfolios are also subject to changes in credit spreads. Our floating rate loans are valued based on a market credit spread to LIBOR. The value of these loans is dependent on 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 affected 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 related losses incurred with respect to our loans would affect us in the same way as similar losses on our real estate securities portfolio as described above, except that our loans are not marked to market.

In addition, widening credit spreads will generally result in a decrease in the mark to market value of certain investments which are treated as derivatives on our balance sheet, such as total rate of return swaps. Since changes in the value of such assets are reflected in our income statement, this would result in a decrease in our net income. To the extent that we choose to make increasing investments in real estate related assets by means of entering into total rate of return swaps, our net income will become more susceptible to decreases stemming from credit spread changes.

Our hedging transactions may limit our gains or result in losses.

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

There are limits to the ability of hedging strategy to protect us completely against interest rate risks. When rates change, we expect the gain or loss on derivatives to be offset by a related but inverse change in the value of the items, generally our liabilities, which we hedge. We cannot assure you, however, that our use of derivatives will offset the risks related to changes in interest rates. We cannot assure you that our hedging strategy and the derivatives that we use will adequately offset the risk of interest rate volatility or that our hedging transactions will not result in losses.

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

Accounting for derivatives under GAAP is extremely complicated. Any failure by us to account for our derivatives properly in accordance with GAAP in our financial statements could adversely affect our earnings.

Prepayment rates can increase, adversely affecting yields on certain investments, including our residential mortgage loans.

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

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

Risks Relating to Our Taxation as a REIT

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

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

If we were to fail to qualify as a REIT in any taxable year, we would be subject to federal income tax, including any applicable alternative minimum tax, on our taxable income at regular corporate rates, and distributions to stockholders would not be deductible by us in computing our taxable income. Any such corporate tax liability could be substantial and would reduce the amount of cash available for distribution to our stockholders, which in turn could have an adverse impact on the value of, and trading prices for, our stock. Unless entitled to relief under certain Internal Revenue Code provisions, we also would be disqualified from taxation as a REIT for the four taxable years following the year during which we ceased to qualify as a REIT. The rule against re-electing REIT status following a loss of such status could also apply to us if Newcastle Investment Holdings Corp., a former stockholder of the Company, failed to qualify as a REIT, and we are treated as a successor to Newcastle Investment Holdings for federal income tax purposes.

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

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

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

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

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

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

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

Even if we remain qualified for taxation as a REIT, we may be subject to certain federal, state and local taxes on our income and assets, including taxes on any undistributed income, tax on income from some activities conducted as a result of a foreclosure, and state or local income, property and transfer taxes, such as mortgage recording taxes. Any of these taxes would decrease cash available for distribution to our stockholders. In addition, in order to meet the REIT qualification requirements, or to avert the imposition of a 100% tax that applies to certain gains derived by a REIT from dealer property or inventory, we may hold some of our assets through taxable REIT subsidiaries. Such subsidiaries will be subject to corporate level income tax at regular rates.

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

To qualify as a REIT for federal income tax purposes, we must continually satisfy tests concerning, among other things, the sources of our income, the nature and diversification of our assets, the amounts we distribute to our stockholders and the ownership of our stock. We also may be required to make distributions to stockholders at disadvantageous times or when we do not have funds readily available for distribution. Thus, compliance with the REIT requirements may hinder our ability to make certain attractive investments.

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

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

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

We conduct our operations so as not to become regulated as an investment company under the Investment Company Act of 1940, as amended. We believe that there are a number of exemptions under the Investment Company Act that may be applicable to us. The assets that we may acquire, therefore, are limited by the provisions of the Investment Company Act and the rules and regulations promulgated under the Investment Company Act. In addition, we could, among other things, be required either (a) to change the manner in which we conduct our operations to avoid being required to register as an investment company or (b) to register as an investment company, either of which could adversely affect us and the market price for our stock.

ERISA may restrict investments by plans in our common stock.

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

Maryland takeover statutes may prevent a change of our control. This could depress our stock price.

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

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

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

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

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

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

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

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

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

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

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

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

Item 1B. Unresolved Staff Comments

We have no unresolved staff comments.

Item 2. Properties.

Our direct investments in properties are described under "Business - Our Investing Activities."

Our manager leases principal executive and administrative offices located at 1345 Avenue of the Americas, New York, New York 10105, 46th floor. Its telephone number is (212) 798-6100.

Item 3. Legal Proceedings.

We are not a party to any material legal proceedings.

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

No matters were submitted to a vote of our security holders during the fourth quarter of 2006.

PART II

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

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

2006	High	Low	Last Sale	Distributions Declared
First Quarter	$27.50	$23.34	$23.92	$0.625
Second Quarter	$26.30	$22.16	$25.32	$0.650
Third Quarter	$28.58	$24.60	$27.41	$0.650
Fourth Quarter	$32.59	$26.78	$31.32	$0.690

2005	High	Low	Last Sale	Distributions Declared
First Quarter	$31.95	$29.27	$29.60	$0.625
Second Quarter	$32.31	$28.25	$30.15	$0.625
Third Quarter	$31.25	$27.00	$27.90	$0.625
Fourth Quarter	$27.96	$24.74	$24.85	$0.625

We intend to continue to declare quarterly distributions on our common stock. No assurance, however, can be given as to the amounts or timing of future distributions as such distributions are subject to our earnings, financial condition, capital requirements and such other factors as our board of directors deems relevant.

On February 16, 2007, the closing sale price for our common stock, as reported on the NYSE, was $31.50. As of February 16, 2007, there were approximately 113 record holders of our common stock. This figure does not reflect the beneficial ownership of shares held in nominee name.

Equity Compensation Plan Information

The following table summarizes the total number of outstanding securities in the incentive plan and the number of securities remaining for future issuance, as well as the weighted average exercise price of all outstanding securities as of December 31, 2006.

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options	Weighted Average Exercise Price of Outstanding Options	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans
Equity Compensation Plans Approved by Security Holders:			
Newcastle Investment Corp. Nonqualified Stock Option and Incentive Award Plan	1,883,807 (1)	$25.89	7,148,169 (2)
Equity Compensation Plans Not Approved by Security Holders:			
None	N/A	N/A	N/A

(1) Includes options for (i) 1,278,014 shares held by an affiliate of our manager; (ii) 591,793 shares granted to our manager and assigned to certain of the manager's employees; and (iii) an aggregate of 14,000 shares held by our directors, other than Mr. Edens.

(2) The maximum available for issuance is equal to 10% of the number of outstanding equity interests, subject to a maximum of 10,000,000 shares in the aggregate over the term of the plan. The number of securities remaining available for future issuance is net of an aggregate of 8,104 shares of our common stock awards to our directors, other than Mr. Edens, representing the aggregate annual automatic stock awards to each such director for 2003 through 2006, and of 959,920 shares issued to certain of our directors and employees of our manager upon the exercise of previously granted options.

Item 6. Selected Financial Data.

The selected historical consolidated financial information set forth below as of December 31, 2006, 2005, 2004, 2003 and 2002 and for the years ended December 31, 2006, 2005, 2004, 2003 and 2002 has been derived from our audited historical consolidated financial statements.

The information below should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and notes thereto included in "Financial Statements and Supplementary Data."

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

	Year Ended December 31,				
	2006	2005	2004	2003	2002 (1)
Operating Data					
Revenues					
Interest income	$ 530,006	$ 348,516	$ 225,761	$ 133,183	$ 73,620
Other income	22,603	29,697	23,908	18,901	18,716
	552,609	378,213	249,669	152,084	92,336
Expenses					
Interest expense	374,269	226,446	136,398	76,877	44,238
Other expense	56,608	42,529	29,259	20,828	18,197
	430,877	268,975	165,657	97,705	62,435
Income before equity in earnings of unconsolidated subsidiaries	121,732	109,238	84,012	54,379	29,901
Equity in earnings of unconsolidated subsidiaries, net	5,968	5,609	9,957	862	362
Income from continuing operations	127,700	114,847	93,969	55,241	30,263
Income from discontinued operations	223	2,108	4,446	877	1,232
Net income	127,923	116,955	98,415	56,118	31,495
Preferred dividends and related accretion	(9,314)	(6,684)	(6,094)	(4,773)	(1,162)
Income available for common stockholders	$ 118,609	$ 110,271	$ 92,321	$ 51,345	$ 30,333
Net income per share of common stock, diluted	$ 2.67	$ 2.51	$ 2.46	$ 1.96	$ 1.68
Income from continuing operations per share of common stock, after preferred dividends, diluted	$ 2.67	$ 2.46	$ 2.34	$ 1.93	$ 1.61
Weighted average number of shares of common stock outstanding, diluted	44,417	43,986	37,558	26,141	18,090
Dividends declared per share of common stock-NCT	$ 2.615	$ 2.500	$ 2.425	$ 1.950	$ 0.850
Dividends declared per share of common stock-predecessor					$ 1.200

	As Of December 31,				
	2006	2005	2004	2003	2002
Balance Sheet Data					
Real estate securities, available for sale	$ 5,581,228	$ 4,554,519	$ 3,369,496	$ 2,192,727	$ 1,025,010
Real estate related loans, net	1,568,916	615,551	591,890	402,784	26,417
Residential mortgage loans, net	809,097	600,682	654,784	586,237	258,198
Operating real estate, net	29,626	16,673	57,193	102,995	113,652
Cash and cash equivalents	5,371	21,275	37,911	60,403	45,463
Total assets	8,604,392	6,209,699	4,932,720	3,550,299	1,574,828
Debt	7,504,731	5,212,358	4,021,396	2,924,552	1,217,007
Total liabilities	7,602,412	5,291,696	4,136,005	3,010,936	1,288,326
Common stockholders' equity	899,480	815,503	734,215	476,863	284,241
Preferred stock	102,500	102,500	62,500	62,500	-
Supplemental Balance Sheet Data					
Common shares outstanding	45,714	43,913	39,859	31,375	23,489
Book value per share of common stock	$ 19.68	$ 18.57	$ 18.42	$ 15.20	$ 12.10

(1) Includes the operations of our predecessor through the date of commencement of our operations, July 12, 2002.

	Year Ended December 31,				
	2006	2005	2004	2003	2002
Other Data					
Cash Flow provided by (used in):					
Operating activities	$ 16,322	$ 98,763	$ 90,355	$ 38,454	$ 21,919
Investing activities	(1,963,058)	(1,334,746)	(1,332,164)	(1,659,026)	(683,053)
Financing activities	1,930,832	1,219,347	1,219,317	1,635,512	675,237
Funds from Operations (FFO) (1)	119,421	104,031	86,201	54,380	37,633

(1) 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 our manager. FFO, for our purposes, represents net income available for common stockholders (computed in accordance with GAAP), excluding extraordinary items, plus depreciation of our 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 our 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.

	Year Ended December 31,				
	2006	2005	2004	2003	2002
Calculation of Funds From Operations (FFO):					
Income available for common stockholders	$ 118,609	$ 110,271	$ 92,321	$ 51,345	$ 30,333
Operating real estate depreciation	812	702	2,199	3,035	7,994
Accumulated depreciation on operating real estate sold	-	(6,942)	(8,319)	-	(2,847)
Other (1)	-	-	-	-	2,153
Funds from operations (FFO)	$ 119,421	$ 104,031	$ 86,201	$ 54,380	$ 37,633

(1) Related to an investment retained by our predecessor

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

The following should be read in conjunction with our consolidated financial statements and notes thereto included in “Financial Statements and Supplementary Data.”

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, when appropriate, which reduces 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, interests in loans and pools of loans, including real estate related loans, commercial mortgage loans, residential mortgage loans, manufactured housing loans and subprime residential 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 December 31, 2006, our debt to equity ratio was approximately 7.5 to 1. On a pro forma basis, our debt to equity ratio would have been 6.7 to 1 if the trust preferred securities we issued in March 2006 were considered equity for purposes of this computation. Also, on a pro forma basis, our debt to equity ratio would have been 6.9 to 1 after adjustment for the common stock issued in January 2007.

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 a multiple forms of financing including collateralized bond obligations (CBOs), other securitizations, term loans, credit facility and trust preferred securities, as well as short term financing in the form of repurchase agreements and asset backed commercial paper.

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 and reduce our financing costs, 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) and increase our financing costs, but increase the yields available on potential new investments.

In 2004 credit spreads on real estate securities tightened to historical lows, before widening in 2005. In 2006, these spreads tightened once again. This tightening of credit spreads and increasing 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 on a net basis from December 31, 2003 to December 31, 2006.

In addition, trends in market interest rates continue to also affect our operations, although to a lesser degree due to our match funded financing strategy. Interest rates had been historically low throughout 2004, before rising in 2005 and continuing to increase in 2006.

Interest rates, as well as property values and other factors, influence the prepayment rates on our investments. Higher prepayment rates can hinder our ability to deploy capital in a timely manner, thereby reducing our return on equity, which occurred in 2005.

We continue to pursue opportunistic investments within our investment guidelines that offer a more attractive risk adjusted return, including investments in subprime mortgage loans and manufactured housing loans which we expect to generate a net, loss adjusted yield in the high teens.

If credit spreads widen and interest rates continue to increase, we expect that our new investment activities will benefit and our earnings will increase, although our net book value per share and the ability to realize gains from existing investments 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."

Formation and Organization

We were formed in 2002 as a subsidiary of Newcastle Investment Holdings Corp. (referred to herein as Holdings). Prior to our initial public offering, Holdings contributed to us certain assets and liabilities in exchange for approximately 16.5 million shares of our common stock. Our operations commenced in July 2002. In May 2003, Holdings distributed to its stockholders all of the shares of our common stock that it held, and it no longer owns any of our common equity.

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
2006	1,800,408	$29.42	$ 51.2
December 31, 2006	45,713,817		
January 2007	2,420,000	$31.30	$ 75.0

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

As of December 31, 2006, approximately 2.9 million of our shares of common stock were held by our manager, through its affiliates, and principals of Fortress. In addition, our manager, through its affiliates, held options to purchase approximately 1.3 million shares of our common stock at December 31, 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 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.

Our discontinued operations include the operations of properties which have been sold or classified as Real Estate Held for Sale pursuant to SFAS No. 144. For more information on these properties, see Note 6 of our consolidated financial statements which appear in "Financial Statements and Supplementary Data." Net proceeds from the sales of such properties have been redeployed to other investments which better meet our strategic objectives.

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

For the Year Ended	Real Estate Securities and Real Estate Related Loans	Residential Mortgage Loans	Operating Real Estate	Unallocated	Total
December 31, 2006	$ 441,965	$ 105,621	$ 5,117	$ (94)	$ 552,609
December 31, 2005	$ 321,889	$ 48,844	$ 6,772	$ 708	$ 378,213
December 31, 2004	$ 225,236	$ 19,135	$ 4,745	$ 553	$ 249,669

Taxation

We have elected to be taxed as a real estate investment trust, or REIT, under the Internal Revenue Code of 1986, as amended (the "Code"), and we intend to continue to operate in such a manner. Our current and continuing qualification as a REIT depends on our ability to meet various tax law requirements, including, among others, requirements relating to the sources of our income, the nature of our assets, the composition of our stockholders, and the timing and amount of distributions that we make.

As a REIT, we will generally not be subject to U.S. federal corporate income tax on our net income that is currently distributed to stockholders. We may, however, nevertheless be subject to certain state, local and foreign income and other taxes, and to U.S. federal income and excise taxes and penalties in certain situations, including taxes on our undistributed income. In addition, our stockholders may be subject to state, local or foreign taxation in various jurisdictions, including those in which they or we transact business or reside. The state, local and foreign tax treatment of us and our stockholders may not conform to the U.S. federal income tax treatment.

If, in any taxable year, we fail to satisfy one or more of the various tax law requirements, we could fail to qualify as a REIT. In addition, if Newcastle Investment Holdings failed to qualify as a REIT and we are treated as a successor to Newcastle Investment Holdings, this could cause us to likewise fail to qualify as a REIT. If we fail to qualify as a REIT for a particular tax year, our income in that year would be subject to U.S. federal corporate income tax (including any applicable alternative minimum tax), and we may need to borrow funds or liquidate certain investments in order to pay the applicable tax, and we would not be compelled by the Code to make distributions. Unless entitled to relief under certain statutory provisions, we would also be disqualified from treatment as a REIT for the four taxable years following the year during which qualification is lost.

Although we currently intend to operate in a manner designed to qualify as a REIT, it is possible that future economic, market, legal, tax or other developments may cause us to fail to qualify as a REIT, or may cause our board of directors to revoke the REIT election.

Application of Critical Accounting Policies

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

Variable Interest Entities

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, which became effective in the first quarter of 2004, 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 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 the adoption of FIN 46R, we consolidated our existing CBO transactions (the "CBO Entities) because we owned the entire equity interest in each of them, representing a substantial portion of their capitalization, and we controlled 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 have therefore continued 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." 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 estimated 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, if necessary, 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. A rollforward of the provision, if any, is included in Note 4 to our consolidated financial statements in “Financial Statements and Supplementary Data.”

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, to be held for investment. We must periodically evaluate each of these loans or loan pools for possible impairment. Impairment is indicated when it is deemed probable that we will be unable to collect all amounts due according to the contractual terms of the loan, or, for loans acquired at a discount for credit losses, when it is deemed probable that we will be unable to collect as anticipated. Upon determination of impairment, we would establish a specific valuation allowance with a corresponding charge to earnings. We continually evaluate our loans receivable for impairment. Our residential mortgage loans, including manufactured housing loans, are aggregated into pools for evaluation based on like characteristics, such as loan type and acquisition date. Individual loans are evaluated based on an analysis of the borrower’s performance, the credit rating of the borrower, debt service coverage and loan to value ratios, the estimated value of the underlying collateral, the key terms of the loan, and the effect of local, industry and broader economic trends and factors. Pools of loans are also evaluated based on similar criteria, including 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 loans acquired at a discount for credit losses, the net income recognized is based on a “loss adjusted yield” whereby a gross interest yield is recorded to Interest Income, offset by a provision for probable, incurred credit losses which is accrued on a periodic basis to 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 5 to our consolidated financial statements in “Financial Statements and Supplementary Data.”

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. 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 $305.7 million of assets purchased from particular counterparties which are financed via $243.7 million of repurchase agreements with the same counterparties at December 31, 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. We understand that 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 $244.3 million and $287.9 million at December 31, 2006 and 2005, respectively.

Results of Operations

We raised a significant amount of capital in offerings in each of these years, resulting in additional capital being deployed to our investments which, in turn, caused changes to our results of operations.

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

	Year-to-Year Increase (Decrease)		Year-to-Year Percent Change		Explanation	
	2006/2005	2005/2004	2006/2005	2005/2004	2006/2005	2005/2004
Interest income	$ 181,490	$ 122,755	52.1%	54.4%	(1)	(1)
Rental and escalation income	(1,786)	1,903	(26.9%)	40.1%	(2)	(2)
Gain on sale of investments	(7,965)	1,991	(39.2%)	10.9%	(3)	(3)
Other income	2,657	1,895	96.8%	222.9%	(4)	(4)
Interest expense	147,823	90,048	65.3%	66.0%	(1)	(1)
Property operating expense	1,442	(212)	61.0%	(8.2%)	(2)	(2)
Loan and security servicing expense	951	2,936	15.9%	96.0%	(1)	(1)
Provision for credit losses	1,017	8,421	12.1%	N/A	(5)	(5)
Provision for losses, loans held for sale	4,127	-	N/A	N/A	(6)	(6)
General and administrative expense	787	(438)	18.9%	(9.5%)	(7)	(7)
Management fee to affiliate	693	2,705	5.2%	25.5%	(8)	(8)
Incentive compensation to affiliate	4,618	(332)	60.5%	(4.2%)	(8)	(8)
Depreciation and amortization	444	190	69.3%	42.1%	(9)	(9)
Equity in earnings of unconsolidated subsidiaries, net	359	(4,348)	6.4%	(43.7%)	(10)	(10)
Income from continuing operations	$ 12,853	$ 20,878	11.2%	22.2%		

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

	Year-to-Year Increase	
	Interest Income	Interest Expense
	2006/2005	2006/2005
Real estate security and loan portfolios (A)	$ 68,911	$ 52,174
Agency RMBS	25,738	24,695
Other real estate related loans	42,899	15,342
Subprime mortgage loan portfolio	41,478	29,671
Credit facility and junior subordinated notes	-	11,305
Manufactured housing loan portfolio (B)	17,323	11,313
Other (C)	9,375	16,908
Residential mortgage loan portfolio (D)	(6,934)	(4,557)
Other real estate related loans (D)	(17,300)	(9,028)
	$ 181,490	$ 147,823

(A) Represents our CBO financings and the acquisition of the related collateral in the respective years.
(B) Primarily due to the acquisition of a manufactured housing loan pool in the third quarter of 2006.
(C) Primarily due to increasing interest rates on floating rate assets and liabilities owned during the period.
(D) These loans received paydowns during the period which served to offset the amounts listed above.

	Year-to-Year Increase	
	Interest Income	Interest Expense
	2005/2004	2005/2004
Real estate security and loan portfolios (A)	$ 61,251	$ 48,213
Agency RMBS	18,350	16,981
Residential mortgage loan portfolio	1,147	5,727
Manufactured housing loan portfolio	27,717	13,164
Other real estate related loans	20,878	3,809
Other (B)	3,181	7,023
ABS - manufactured housing portfolio (C)	(2,777)	(426)
ICH loan portfolio (C)	(3,963)	(3,655)
Other real estate related loans (C)	(3,029)	(788)
	$ 122,755	$ 90,048

(A) Represents our CBO financings and the acquisition of the related collateral in the respective years.

(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.

Changes in loan and security servicing expenses 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) These changes are 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.

(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 increase from 2004 to 2005 is primarily the result of the acquisition of manufactured housing and residential mortgage loan pools at a discount for credit quality and $2.9 million of impairment recorded with respect to the ICH loans in 2005. The increase from 2005 to 2006 is primarily due to the acquisition of manufactured housing loans at a discount for credit quality which is offset by less impairment recorded with respect to the ICH loans.

(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 changes in general and administrative expense are primarily increases as a result of our increased size, offset by decreased professional fees in 2005.

(8) The increases in management fees are a result of our increased size resulting from our equity issuances during these periods. The changes in incentive compensation are primarily a result of our increased earnings, offset by FFO losses recorded with respect to the sale of properties during 2004 and 2005.

(9) The increase in depreciation is primarily due to the implementation 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 change from 2004 to 2005 is related to an interest in an LLC which held a portfolio of convenience and retail gas stores that was acquired with the intent to sell. All sales were completed in 2005. The change from 2005 to 2006 is the result of a small improvement in operating performance. Note that the amounts shown are net of income taxes on related taxable subsidiaries.

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 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 $185 million remained available as of February 16, 2007.

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 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 December 31, 2006, we had an unrestricted cash balance of $5.4 million and an undrawn balance of $106.2 million on our credit facility. Our cash flow provided by operations differs from our net income due to several 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 rate of return swaps, as described below. 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. As of December 31, 2006 we had $123.9 million of restricted cash held in CBO financing structures pending its investment in real estate securities and loans.

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 limited 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 and asset backed commercial paper, 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 $2.4 million relating to tenant improvements in connection with the inception of leases and capital expenditures during the year ending December 31, 2007.

With respect to one of our real estate related loans, we were committed to fund up to an additional $6.6 million at December 31, 2006, subject to certain conditions to be met by the borrower.

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 or total rate of return swaps. 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 do not expect these potential margin calls to materially affect our financial condition or results of operations.

Debt Obligations

The following table presents certain information regarding our debt obligations and related hedges as of December 31, 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	$ 398,366	$ 395,646	6.94% (2)	Jul 2038	5.50%	1.99	$ 303,366	$ 544,469	4.06	$ -	$ 255,352
Real estato securities and loans	Apr 2002	444,000	441,660	6.42% (2)	Apr 2037	6.78%	3.45	372,000	498,754	5.15	59,612	296,000
Real estate securities and loans	Mar 2003	472,000	468,944	6.23% (2)	Mar 2038	5.35%	5.30	427,800	515,335	4.56	128,600	285,060
Real estate securities and loans	Sep 2003	460,000	456,250	6.08% (2)	Sep 2038	5.88%	5.85	442,500	505,450	4.28	151,677	207,500
Real estate securities and loans	Mar 2004	414,000	411,014	5.93% (2)	Mar 2039	5.38%	5.61	382,750	446,749	4.76	174,192	177,300
Real estate securities and loans	Sep 2004	454,500	451,137	5.91% (2)	Sep 2039	5.49%	6.19	442,500	499,389	5.08	227,898	209,202
Real estate securities and loans	Apr 2005	447,000	442,870	5.81% (2)	Apr 2040	5.53%	7.16	439,600	491,398	5.82	195,186	242,990
Real estate securities	Dec 2005	442,800	438,894	5.85% (2)	Dec 2050	5.57%	8.48	436,800	512,249	7.23	115,491	341,506
Real .estate securities and loans	Nov 2006	807,500	807,409	5.98% (2)	Nov 2052	5.92%	7.06	799,900	930,293	4.69	672,217	153,655
		4,340,166	4,313,824			5.73%	5.83	4,047,216	4,944,086	5.05	1,724,873	2,168,565
Other Bonds Payable												
ICH loans (3)	(3)	101,925	101,925	6.78% (2)	Aug 2030	6.78%	1.04	1,986	121,834	1.10	1,986	-
Manufactured housing loans	Jan 2006	213,172	211,738	LIBOR +1.25%	Jan 2009	6.14%	1.46	213,172	237,133	6.26	4,977	204,617
Manufactured housing loans	Aug 2006	364,794	362,181	LIBOR +1.25%	Aug 2011	6.87%	3.07	364,794	399,125	5.87	73,973	370,466
		679,891	675,844			6.63%	2.26	579,952	758,092	5.25	80,936	575,083
Notes Payable												
Residential mortgago loans (4)	Nov 2004	128,866	128,866	LIBOR+ 0.16%	Nov 2007	5.68%	0.74	128,866	145,819	2.79	142,301	-
Repurchase Agreements (4) (7)												
Real estate securities	Rolling	181,059	181,059	LIBOR + 0.41%	Jan 2007	5.62%	0.08	181,059	207,374	4.60	101,380	92,457
Real estate related loans	Rolling	553,944	553,944	LIBOR + 0.69%	Jan 2007	6.02%	0.08	553,944	718,989	2.21	696,174	19,630
Residential mortgage loans	Rolling	25,343	25,343	LIBOR + 0.43%	Mar 2007	5.79%	0.23	25,343	27,020	2.81	26,347	-
		760,346	760,346			5.92%	0.08	760,346	953,383	2.77	823,901	112,087
Repurchase agreements subject to ABCP facility (8)												
Agency RMBS	Dec 2006	1,143,749	1,143,749	5.41%	Jan 2007	4.97%	0.08	1,143,749	1,176,358	4.27	-	1,087,385
Credit facility (5)	May 2006	93,800	93,800	LIBOR +1.75%	Nov 2007	7.08%	0.85	93,800	-	-	-	-
Junior subordinated notes payable	Mar 2006	100,100	100,100	7.80% (6)	Apr 2036	7.72%	29.25	-	-	-	-	-
Subtotal debt obligations		7,246,918	7,216,529			5.76%	4.15	$ 6,753,929	$ 7,977,738	4.63	$ 2,772,011	$ 3,943,120
Financing on subprime mortgage loans subject to future repurchase (8)	Apr 2006	299,176	288,202									
Total debt obligations		$ 7,546,094	$ 7,504,731									

(1) Including the effect of applicable hedges.
(2) Weighted average, including floating and fixed rate classes.
(3) See "Business-Our Investing Activities-Real Estate Related Loans" above.
(4) Subject to potential mandatory prepayments based on collateral value.
(5) A maximum of $200 million can be drawn.
(6) LIBOR + 2.25% after April 2016.
(7) The counterparties on our repurchase agreements include: Bear Stearns Mortgage Capital Corporation ($270.6 million), Credit Suisse ($216.2 million), Deutsche Bank AG ($181.7 million) and other ($91.8 million).
(8) See "Liquidity and Capital Resources" below.

Our debt obligations existing at December 31, 2006 (gross of $41.4 million of discounts) have contractual maturities as follows (unaudited) (in thousands):

2007	$ 2,126,761
2008	-
2009	213,172
2010	-
2011	364,794
Thereafter	4,841,367
Total	$ 7,546,094

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.

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 December 31, 2006.

Two classes of separately issued 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.

Two classes of CBO bonds, with an aggregate $50.0 million of face amount, were upgraded to a rating of A+ by Fitch in 2006.

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.

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. 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. 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.

In November 2006, we closed our ninth CBO financing to term finance a $950 million portfolio of real estate securities and loans. Approximately 69%, or $560.5 million, of the debt issued, all of which is investment grade, is rated AAA.

In December 2006, we closed a $2 billion asset backed commercial paper (ABCP) facility through our wholly owned subsidiary, Windsor Funding Trust. This facility provides us with the ability to finance our agency residential mortgage backed securities (RMBS) and AAA-rated MBS by issuing secured liquidity notes that are rated A-1+, P-1 and F-1+, by Standard & Poor's, Moody's and Fitch respectively, and have maturities of up to 250 days. The facility also permits the issuance of subordinated notes rated at least BBB/Baa by Standard & Poor's, Moody's or Fitch. As of December 31, 2006, Windsor Funding Trust had approximately $1.1 billion of secured liquidity notes and $8.3 million of subordinated notes issued and outstanding. The weighted average maturities of the secured liquidity notes and the subordinated notes were 0.12 years and 5 years, respectively. We own all of the trust certificates of the Windsor Funding Trust. Windsor Funding Trust used the proceeds of the issuance to enter into a repurchase agreement with Newcastle to purchase interests in our agency RMBS. The repurchase agreement represents Windsor Funding Trust's only asset. The interest rate on the repurchase agreement is effectively the weighted average interest rate on the secured liquidity notes and subordinated notes. Under the provisions of FIN 46R, we determined that the noteholders were the primary beneficiaries of the Windsor Funding Trust. As a result, we did not consolidate the Windsor Funding Trust and have reflected our obligation pursuant to the asset backed commercial paper facility under the caption Repurchase Agreements subject to ABCP Facility.

In January 2007, we entered into an $700 million non-recourse 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%.

Other

We have entered into total rate of return swaps with major investment banks 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 December 31, 2006 we held an aggregate of $299.7 million notional amount of total rate of return swaps on 8 reference assets on which we had deposited $46.8 million of margin. These total rate of return swaps had an aggregate fair value of approximately $1.3 million, a weighted average receive interest rate of LIBOR + 2.59%, a weighted average pay interest rate of LIBOR + 0.63%, and a weighted average swap maturity of 1.5 years.

Stockholders' Equity

Common Stock

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

Year	Shares Issued	Range of Issue Prices per Share (1)	Net Proceeds (millions)	Options Granted to Manager
Formation	16,488,517	N/A	N/A	N/A
2002	7,000,000	$13.00	$ 80.0	700,000
2003	7,886,316	$20.35-$22.85	$ 163.4	788,227
2004	8,484,648	$26.30-$31.40	$ 224.3	837,500
2005	4,053,928	$29.60	$ 108.2	330,000
2006	1,800,408	$29.42	$ 51.2	170,000
December 31, 2006	45,713,817			
January 2007	2,420,000	$31.30	$ 75.0	242,000

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

Through December 31, 2006, our manager had assigned, for no value, options to purchase approximately 0.9 million shares of our common stock to certain of our manager's employees, of which approximately 0.3 million had been exercised. In addition, our manager had exercised 0.7 million of its options.

As of December 31, 2006, our outstanding options had a weighted average strike price of $25.89 and were summarized as follows:

Held by our manager	1,278,014
Issued to our manager and subsequently assigned to certain of our manager's employees	591,793
Held by directors and former directors	14,000
Total	1,883,807

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. If the Series C Preferred ceases to be listed on the NYSE or the AMEX, or quoted on the NASDAQ, and we are not subject to the reporting requirements of the Exchange Act, we have the option to redeem the Series C Preferred at their face amount and, during such time any shares of Series C Preferred are outstanding, the dividend will increase to 9.05% per annum.

Other Comprehensive Income

During the year ended December 31, 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 gain on securities		26,242
Reclassification of net realized (gain) on securities into earnings		(282)
Foreign currency translation		(26)
Net unrealized gain on derivatives designated as cash flow hedges		7,773
Reclassification of net realized (gain) on derivatives designated as cash flow hedges into earnings		(3,287)
Accumulated other comprehensive income, December 31, 2006	$	75,984

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 year, the combination of tightening credit spreads and increasing interest rates has resulted in a net increase in unrealized gains on our real estate securities and derivatives. We believe that our ongoing investment activities benefit in general from an environment of widening credit spreads and increasing interest rates. 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

Declared for the Period Ended	Paid	Amount Per Share
March 31, 2004	April 2004	$ 0.600
June 30, 2004	July 2004	$ 0.600
September 30, 2004	October 2004	$ 0.600
December 31, 2004	January 2005	$ 0.625
March 31, 2005	April 2005	$ 0.625
June 30, 2005	July 2005	$ 0.625
September 30, 2005	October 2005	$ 0.625
December 31, 2005	January 2006	$ 0.625
March 31, 2006	April 2006	$ 0.625
June 30, 2006	July 2006	$ 0.650
September 30, 2006	October 2006	$ 0.650
December 31, 2006	January 2007	$ 0.690

Cash Flow

Net cash flow provided by operating activities decreased from $98.8 million for the year ended December 31, 2005 to $16.3 million for the year ended December 31, 2006. It increased from $90.4 million for the year ended December 31, 2004 to $98.8 million for the year ended December 31, 2005. These changes primarily resulted from the acquisition and settlement of our investments as described above.

Investing activities used ($1,963.1 million), ($1,334.7 million) and ($1,332.2 million) during the years ended December 31, 2006, 2005 and 2004, respectively. Investing activities consisted primarily of the investments made in real estate securities and loans, net of proceeds from the sale or settlement of investments.

Financing activities provided $1,930.8 million, $1,219.3 million and $1,219.3 million during the years ended December 31, 2006, 2005 and 2004, 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 in our consolidated financial statements included in “Financial Statements and Supplementary Data” for a reconciliation of our cash position for the periods described herein.

Interest Rate, Credit and Spread Risk

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

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) when appropriate, 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.

Real Estate Securities

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 and loan 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 effected similarly by changes in LIBOR spreads. Such changes in the market value of our real estate securities portfolio may effect our net equity, net income or cash flow directly through their impact on the amount of unrealized gains or losses on available-for-sale securities, and therefore on 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 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.

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 these 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 or commercial paper were to decline, it could affect our ability to refinance such loans upon the maturity of the related repurchase agreements or commercial paper.

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 our ability to pay dividends.

Statistics

	December 31, 2006		December 31, 2005	
	Face Amount	% Total	Face Amount	% Total
Real Estate Securities and Related Loans	$ 6,196,179	71.7%	$ 4,802,172	76.1%
Agency RMBS	1,177,779	13.6%	697,530	11.0%
Total Real Estate Securities and Related Loans	7,373,958	85.3%	5,499,702	87.1%
Residential Mortgage Loans	812,561	9.4%	610,970	9.7%
Other				
Subprime Loans Subject to Future Repurchase	299,176	3.5%	-	0.0%
Investment in Joint Venture	38,469	0.4%	38,164	0.6%
ICH Loans	123,390	1.4%	165,514	2.6%
Total Portfolio	$ 8,647,554	100.0%	$ 6,314,350	100.0%

The table excludes operating real estate of $33.8 million at December 31, 2006 and $20.2 million at December 31, 2005.

Asset Quality and Diversification at December 31, 2006

- Total real estate securities and related loans of $7.4 billion face amount, representing 85.3% of the total portfolio
  Asset Quality
  - $6.0 billion or 81.5% of this portfolio is rated by third parties, or had an implied AAA rating, with a weighted average rating of BBB+.
  - $1.4 billion or 18.5% of this portfolio is not rated by third parties but had a weighted average loan to value ratio of 68.6%.
  - 63% of this portfolio has an investment grade rating (BBB- or higher).
  - The weighted average credit spread (i.e., the yield premium on our investments over the comparable US Treasury or LIBOR) for the core real estate securities and related loans of $6.2 billion (excluding agency RMBS) was 2.56%.

  Diversity
  - Our real estate securities and loans are diversified by asset type, industry, location and issuer.
  - This portfolio had 635 investments. The largest investment was $179.5 million and the average investment size was $11.6 million.
  - Our real estate securities are supported by pools of underlying loans. For instance, our CMBS investments had over 21,000 underlying loans.
- Residential mortgage loans of $0.8 billion face amount, representing 9.4% of the total portfolio
  Asset Quality
  - These residential loans are to high quality borrowers with an average Fair Isaac Corp. credit score ("FICO") of 697.
  - Approximately $142.3 million face amount were held in securitized form, of which 95.7% was rated investment grade.

Diversity

- o Our residential and manufactured housing loans were well diversified with 491 and 18,343 loans, respectively.

Margin

Certain of our investments are financed through repurchase agreements or total rate of 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 December 31, 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 four unconsolidated subsidiaries. See Note 3 to our consolidated financial statements in "Financial Statements and Supplementary Data."

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

As of December 31, 2006, we had the following material contractual obligations (payments in thousands):

Contract	Terms
CBO bonds payable	Described under "Quantitative and Qualitative Disclosures About Market Risk"
Other bonds payable	Described under "Quantitative and Qualitative Disclosures About Market Risk"
Notes payable	Described under "Quantitative and Qualitative Disclosures About Market Risk"
Repurchase agreements	Described under "Quantitative and Qualitative Disclosures About Market Risk"
Repurchase agreements subject to ABCP facility	We entered into a repurchase agreement with our wholly owned subsidiary Windsor Funding Trust as described under "Liquidity and Capital Resources"
Credit facility	Described under "Quantitative and Qualitative Disclosures About Market Risk"
Junior subordinated notes payable	Described under "Quantitative and Qualitative Disclosures About Market Risk"
Interest rate swaps, treated as hedges	Described under "Quantitative and Qualitative Disclosures About Market Risk"
Non-hedge derivative obligations	Described under "Quantitative and Qualitative Disclosures About Market Risk"
CBO wrap agreement	Two classes of our 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, pursuant to a financial guaranty insurance policy ("wrap"). We pay annual fees of 0.12% of the outstanding face amount of the bonds under this agreement.

CBO backstop agreements	In connection with the remarketing procedures described above, backstop agreements have been created whereby a third party financial institution is required to purchase the $718.0 million face amount of bonds at the end of any remarketing period if such bonds could not be resold in the market by the remarketing agent. We pay annual fees between 0.15% and 0.20% of the outstanding face amount of such bonds under these agreements.
CBO remarketing agreements	In connection with the remarketing procedures described above, the remarketing agent is paid an annual fee of 0.05% of the outstanding face amount of the bonds under the remarketing agreements.
Subprime loan securitization	We entered into the securitization of our subprime mortgage loan portfolio as described under "Liquidity and Capital Resources."
Loan servicing agreements	We are a party to servicing agreements with respect to our residential mortgage loans, including manufactured housing loans and subprime mortgage loans, and our ICH loans. We pay annual fees generally equal to 0.38% of the outstanding face amount of the residential mortgage loans, 1.00% and 0.625% of the outstanding face amount of the two portfolios of manufactured housing loans, respectively, and approximately 0.11% of the outstanding face amount of the ICH loans under these agreements. Our subprime loans are held off balance sheet.
Trustee agreements	We have entered into trustee agreements in connection with our securitized investments, primarily our CBOs. We pay annual fees of between 0.015% and 0.020% of the outstanding face amount of the CBO bonds under these agreements.
Management agreement	Our manager is paid an annual management fee of 1.5% of our gross equity, as defined, an expense reimbursement, and incentive compensation equal to 25% of our FFO above a certain threshold. For more information on this agreement, as well as historical amounts earned, see Note 10 to our audited consolidated financial statements under "Financial Statements and Supplementary Data."

	Actual Payments	Fixed and Determinable Payments Due by Period (2)				
Contract	2006 (1)	2007	2008-2009	2010-2011	Thereafter	Total
CBO bonds payable	$ 233,913	$ -	$ -	$ -	$ 4,340,166	$ 4,340,166
Other bonds payable	335,625	-	213,172	364,794	101,925	679,891
Notes payable	141,584	128,866	-	-	-	128,866
Repurchase agreements	2,872,327	760,346	-	-	-	760,346
Repurchase agreements subject to ABCP facility	181,605	1,143,749	-	-	-	1,143,749
Financing of subprime mortgage loans subject to future repurchase	-	-	-	-	299,176	299,176
Credit facility	501,202	93,800	-	-	-	93,800
Junior subordinated notes payable	4,444	-	-	-	100,100	100,100
Interest rate swaps, treated as hedges	3,197	(3)	(3)	(3)	(3)	(3)
Non-hedge derivative obligations	34	(3)	(3)	(3)	(3)	(3)
CBO wrap agreement	481	(3)	(3)	(3)	(3)	(3)
CBO backstop agreements	1,292	(3)	(3)	(3)	(3)	(3)
CBO remarketing agreements	364	(3)	(3)	(3)	(3)	(3)
Subprime loan securitization	1,462,427	(3)	(3)	(3)	(3)	(3)
Loan servicing agreements	4,755	(3)	(3)	(3)	(3)	(3)
Trustee agreements	826	(3)	(3)	(3)	(3)	(3)
Management agreement	21,581	(3)	(3)	(3)	(3)	(3)
Total	$ 5,765,657	$ 2,126,761	$ 213,172	$ 364,794	$ 4,841,367	$ 7,546,094

(1) Includes all payments made under the respective agreements. The management agreement payments shown include $14.0 million of management fees and expense reimbursements and $7.6 million of incentive compensation.
(2) Represents debt principal due based on contractual maturities.
(3) These contracts do not have fixed and determinable payments.

Inflation

We believe that our risk of increases in 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 Funds from Operations (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 our manager. FFO, for our purposes, represents net income available for common stockholders (computed in accordance with GAAP), excluding extraordinary items, plus depreciation of our 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 Year Ended December 31,		
	2006	2005	2004
Income available for common stockholders	$ 118,609	$ 110,271	$ 92,321
Operating real estate depreciation	812	702	2,199
Accumulated depreciation on operating real estate sold	-	(6,942)	(8,319)
Funds from operations (FFO)	$ 119,421	$ 104,031	$ 86,201

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

	Book Equity December 31,	Average Invested Common Equity for the Year Ended December 31,	FFO for the Year Ended December 31,	Return on Invested Common Equity (3) for the Year Ended December 31,		
	2006 (1)	2006 (2)	2006	2006	2005	2004
Real estate securities and real estate related loans	$ 998,473	$ 903,165	$ 146,048	16.2%	17.9%	20.5%
Residential mortgage loans	125,647	109,966	21,596	19.6%	9.1%	16.7%
Operating real estate	49,085	46,331	3,831	8.3%	3.5%	9.2%
Unallocated (1)	(345,521)	(260,045)	(52,054)	N/A	N/A	N/A
Total (2)	827,684	$ 799,417	$ 119,421	14.9%	13.4%	14.5%
Preferred stock	102,500					
Accumulated depreciation	(4,188)					
Accumulated other comprehensive income	75,984					
Net book equity	$ 1,001,980					

(1) Unallocated FFO represents ($11.7 million) of interest expense, ($9.3 million) of preferred dividends and ($31.1 million) of corporate general and administrative expense, management fees and incentive compensation.

(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.

Related Party Transactions

In November 2003, we and a private investment fund managed by an affiliate of our manager co-invested and each indirectly own an approximately 38% interest in a limited liability company that acquired a pool of franchise loans from a third party financial institution. Our investment in this entity, reflected as an investment in an unconsolidated subsidiary on our consolidated balance sheet, was approximately $10.2 million at December 31, 2006. The remaining approximately 24% interest in the limited liability company is owned by the above referenced third party financial institution.

As of December 31, 2006, we owned an aggregate of approximately $108.0 million of securities of Global Signal Trust II and III, special purpose vehicles established by Global Signal Inc., which were purchased in private placements from underwriters in January 2004, April 2005 and February 2006. Our CEO and chairman of our board of directors was 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 January 2007, Global Signal was acquired by Crown Castle International Corp. Newcastle's affiliate no longer had significant influence over Global Signal subsequent to the acquisition.

In March 2004, we and a private investment fund managed by an affiliate of our manager co-invested and each indirectly own an approximately 49% interest in two limited liability companies that have acquired, in a sale-leaseback transaction, a portfolio of convenience and retail gas stores from a public company. The properties are subject to a number of master leases, the initial term of which in each case is a minimum of 15 years. This investment was financed with nonrecourse debt at the limited liability company level and our investment in this entity, reflected as an investment in an unconsolidated subsidiary on our consolidated balance sheet, was approximately $12.5 million at December 31, 2006. In March 2005, the property management agreement related to these properties was transferred to an affiliate of our manager from a third party servicer; our allocable portion of the related fees, approximately $20,000 per year for three years, was not changed.

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. The outstanding unpaid principal balance of this portfolio was approximately $245.7 million at December 31, 2006.

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 $1.2 billion at December 31, 2006.

In August 2006, we acquired a portfolio of manufactured housing loans. 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 $398.3 million at December 31, 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. 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 us owning a 20% interest in the junior participation interest in the loan. Our investment in this loan was approximately $26.1 million at December 31, 2006.

As of December 31, 2006, we held total investments of $192.2 million face amount of real estate securities and real estate related loans issued by affiliates of our manager and earned approximately $18.5 million, $13.7 million and $13.1 million of interest on investments issued by affiliates for the years ended December 31, 2006, 2005 and 2004, respectively.

In each instance described above, affiliates of our manager have an investment in the applicable affiliated fund and receive from the fund, in addition to management fees, incentive compensation if the fund's aggregate investment returns exceed certain thresholds.

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

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

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 December 31, 2006, a 100 basis point increase in short term interest rates would increase our earnings by approximately $0.2 million per annum.

A period of rising interest rates 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 would 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 December 31, 2006, a 100 basis point change in short term interest rates would impact our net book value by approximately $65.7 million.

Our general financing strategy focuses on the use of match funded structures. This means that, when appropriate, 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 upfront 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 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 effect 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 these 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 or commercial paper were to decline, it could affect our ability to refinance such loans upon the maturity of the related repurchase agreements or commercial paper.

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 December 31, 2006, a 25 basis point movement in credit spreads would impact our net book value by approximately $62.5 million, but would not directly affect our earnings or cash flow.

Margin

Certain of our investments are financed through repurchase agreements or total rate of 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 Value

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 December 31, 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 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 December 31, 2006 (in thousands):

	Carrying Value December 31,		December 31, 2006			Fair Value December 31,	
	2006	2005	Principal Balance or Notional Amount	Weighted Average Yield/ Funding Cost	Maturity Date	2006	2005
Assets:							
Real estate securities, available for sale (1)	$ 5,581,228	$ 4,554,519	$ 5,604,249	6.60%	(1)	$ 5,581,228	$ 4,554,519
Real estate related loans (2)	1,568,916	615,551	1,573,570	8.48%	(2)	1,571,412	615,865
Residential mortgage loans (3)	809,097	600,682	812,561	8.03%	(3)	829,980	609,486
Subrpime mortgage loans subject to future repurchase (4)	288,202	-	299,176	(4)	(4)	288,202	-
Interest rate caps, treated as hedges (5)	1,262	2,145	334,971	N/A	(5)	1,262	2,145
Total rate of return swaps (6)	1,288	3,096	299,654	N/A	(6)	1,288	3,096
Liabilities:							
CBO bonds payable (7)	4,313,824	3,530,384	4,340,166	5.73%	(7)	4,369,540	3,594,638
Other bonds payable (8)	675,844	353,330	679,891	6.63%	(8)	676,512	356,294
Notes payable (9)	128,866	260,441	128,866	5.68%	(9)	128,866	260,441
Repurchase agreements (10)	760,346	1,048,203	760,346	5.92%	(10)	760,346	1,048,203
Repurchase agreements subject to ABCP facility (10)	1,143,749	-	1,143,749	4.97%	(10)	1,143,749	-
Financing of subrpime mortgage loans subject to future repurchase (4)	288,202	-	299,176	(4)	(4)	288,202	-
Credit facility (11)	93,800	20,000	93,800	7.08%	(11)	93,800	20,000
Junior subordinated notes payable (12)	100,100	-	100,100	7.72%	(12)	101,629	-
Interest rate swaps, treated as hedges (13)	(42,887)	(41,170)	3,943,120	N/A	(13)	(42,887)	(41,170)
Non-hedge derivatives (14)	360	90	(14)	N/A	(14)	360	90

(1) These securities contain various terms, including fixed and floating rates, self-amortizing and interest only. Their weighted average maturity is 5.02 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 Carrying Value	Fair Value
B-Notes	$ 248,240	$ 246,798	7.98%	2.71	73.0%	$ 248,662
Mezzanine Loans	906,907	904,686	8.61%	2.67	97.5%	904,996
Bank Loans	233,793	233,895	7.75%	3.92	100.0%	234,680
Whole Loans	61,240	61,703	12.63%	1.81	100.0%	61,240
ICH Loans	123,390	121,834	7.77%	1.10	1.6%	121,834
	$ 1,573,570	$ 1,568,916	8.48%	2.71	86.7%	$ 1,571,412

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 and two portfolios of substantially fixed rate manufactured housing loans. The $168.6 million portfolio of residential mortgage loans has a weighted average maturity of 2.79 years. The $643.9 million portfolios of manufactured housing loans have a weighted average maturity of 6.02 years. These loans were valued by reference to current market interest rates and credit spreads.

(4) These two 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
$ 255,352	Current	March 2009	1-Month LIBOR	6.50%	$ 31
18,000	January 2010	October 2015	3-Month LIBOR	8.00%	154
8,619	December 2010	June 2015	3-Month LIBOR	7.00%	371
53,000	May 2011	September 2015	1-Month LIBOR	7.50%	706
$ 334,971					$ 1,262

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

(6) Represents total 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 5.83 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 1.04 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 2.48 years. 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 0.74 years and is subject to adjustment monthly based on the agreed upon 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 0.08 years.

(11) This facility, which has a weighted average maturity of 0.85 years, bears a floating rate of interest. This facility was valued at par because management believes it could currently enter into a similar arrangement under similar terms.

(12) These notes have a weighted average maturity of 29.25 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	May2009	$ 331,620*	3.27%	$ (9,517)
2010	Jun 2010	402,533	4.37%	(6,211)
2011	Jun 2011	591,800	5.24%	2,688
2012	Jan 2012	127,001	4.92%	(546)
2015	Jul 2015	776,996	4.92%	(7,465)
2016	Apr 2016	728,738	5.18%	2,776
Agreements which receive 3-Month LIBOR:				
2011	Apr 2011	337,000	5.81%	7,785
2013	Mar 2013	276,060	3.87%	(15,183)
2014	Jun 2014	357,852	4.21%	(17,603)
2016	Apr 2016	13,520	5.57%	389
		$ 3,943,120		$ (42,887)

* $255,352 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 $59.6 million of gross interest rate swap assets and $16.7 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.

Item 8. Financial Statements and Supplementary Data.

Index to Financial Statements:

Report of Independent Registered Public Accounting Firm

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

Consolidated Balance Sheets as of December 31, 2006 and December 31, 2005

Consolidated Statements of Income for the years ended December 31, 2006, 2005 and 2004

Consolidated Statements of Stockholders' Equity for the years ended December 31, 2006, 2005 and 2004

Consolidated Statements of Cash Flow for the years ended December 31, 2006, 2005 and 2004

Notes to Consolidated Financial Statements

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

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders of Newcastle Investment Corp.

We have audited the accompanying consolidated balance sheets of Newcastle Investment Corp. and subsidiaries (the "Company") as of December 31, 2006 and 2005, and the related consolidated statements of income, stockholders' equity, and cash flow for each of the three years in the period ended December 31, 2006. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company at December 31, 2006 and 2005, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness the Company's internal control. over financial reporting as of December 31, 2006, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 22, 200.7 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

New York, NY
February 22, 2007

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

The Board of Directors and Stockholders of Newcastle Investment Corp.

We have audited management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting, that Newcastle Investment Corp. and subsidiaries (the "Company") maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

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

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

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

In our opinion, management's assessment that the Company maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of the Company as of December 31, 2006 and 2005, and the related consolidated statements of income, stockholders' equity, and cash flow for each of the three years in the period ended December 31, 2006 of the Company and our report dated February 22, 2007 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

New York, NY
February 22, 2007

NEWCASTLE INVESTMENT CORP. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(dollars in thousands, except share data)

	December 31,	
	2006	**2005**
Assets		
Real estate securities, available for sale - Note 4	$ 5,581,228	$ 4,554,519
Real estate related loans, net - Note 5	1,568,916	615,551
Residential mortgage loans, net - Note 5	809,097	600,682
Subprime mortgage loans subject to future repurchase - Note 5	288,202	-
Investments in unconsolidated subsidiaries - Note 3	22,868	29,953
Operating real estate, net - Note 6	29,626	16,673
Cash and cash equivalents	5,371	21,275
Restricted cash	184,169	268,910
Derivative assets - Note 7	62,884	63,834
Receivables and other assets	52,031	38,302
	$ 8,604,392	$ 6,209,699
Liabilities and Stockholders' Equity		
Liabilities		
CBO bonds payable - Note 8	$ 4,313,824	$ 3,530,384
Other bonds payable - Note 8	675,844	353,330
Notes payable - Note 8	128,866	260,441
Repurchase agreements - Note 8	760,346	1,048,203
Repurchase agreements subject to ABCP facility - Note 8	1,143,749	
Financing of subprime mortgage loans subject to future repurchase - Notes 5 and 8	288,202	-
Credit facility - Note 8	93,800	20,000
Junior subordinated notes payable (security for trust preferred) - Note 8	100,100	-
Derivative liabilities - Note 7	17,715	18,392
Dividends payable	33,095	29,052
Due to affiliates - Note 10	13,465	8,783
Accrued expenses and other liabilities	33,406	23,111
	7,602,412	5,291,696
Commitments and contingencies - Notes 9, 10 and 11		
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, 45,713,817 and 43,913,409 shares issued and outstanding at December 31, 2006 and 2005, respectively	457	439
Additional paid-in capital	833,887	782,735
Dividends in excess of earnings - Note 2	(10,848)	(13,235)
Accumulated other comprehensive income - Note 2	75,984	45,564
	1,001,980	918,003
	$ 8,604,392	$ 6,209,699

See notes to consolidated financial statements.

NEWCASTLE INVESTMENT CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME
(dollars in thousands, except share data)

	Year Ended December 31,		
	2006	**2005**	**2004**
Revenues			
Interest income	$ 530,006	$ 348,516	$ 225,761
Rental and escalation income	4,861	6,647	4,744
Gain on sale of investments, net	12,340	20,305	18,314
Other income, net	5,402	2,745	850
	552,609	378,213	249,669
Expenses			
Interest expense	374,269	226,446	136,398
Property operating expense	3,805	2,363	2,575
Loan and security servicing expense	6,944	5,993	3,057
Provision for credit losses	9,438	8,421	-
Provision for losses, loans held for sale - Note 5	4,127	-	-
General and administrative expense	4,946	4,159	4,597
Management fee to affiliate - Note 10	14,018	13,325	10,620
Incentive compensation to affiliate - Note 10	12,245	7,627	7,959
Depreciation and amortization	1,085	641	451
	430,877	268,975	165,657
Income before equity in earnings of unconsolidated subsidiaries	121,732	109,238	84,012
Equity in earnings of unconsolidated subsidiaries - Note 3	5,968	5,930	12,465
Income taxes on related taxable subsidiaries - Note 12	-	(321)	(2,508)
Income from continuing operations	127,700	114,847	93,969
Income from discontinued operations - Note 6	223	2,108	4,446
Net Income	127,923	116,955	98,415
Preferred dividends	(9,314)	(6,684)	(6,094)
Income Available For Common Stockholders	$ 118,609	$ 110,271	$ 92,321
Net Income Per Share of Common Stock			
Basic	$ 2.68	$ 2.53	$ 2.50
Diluted	$ 2.67	$ 2.51	$ 2.46
Income from continuing operations per share of common stock, after preferred dividends			
Basic	$ 2.67	$ 2.48	$ 2.38
Diluted	$ 2.67	$ 2.46	$ 2.34
Income from discontinued operations per share of common stock			
Basic	$ 0.01	$ 0.05	$ 0.12
Diluted	$ 0.00	$ 0.05	$ 0.12
Weighted Average Number of Shares of Common Stock Outstanding			
Basic	44,268,575	43,671,517	36,943,752
Diluted	44,417,113	43,985,642	37,557,790
Dividends Declared per Share of Common Stock	$ 2.615	$ 2.500	$ 2.425

See notes to consolidated financial statements.

NEWCASTLE INVESTMENT CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2006, 2005 and 2004

	Preferred Stock		Common Stock					
	Shares	Amount	Shares	Amount	Additional Paid in Capital	Dividends in Excess of Earnings	Accumulated Other Comp. Income	Total Stock-holders' Equity
Stockholders' equity - December 31, 2005	4,100,000	$ 102,500	43,913,409	$ 439	$ 782,735	$ (13,235)	$ 45,564	$ 918,003
Dividends declared	-	-	-	-	-	(125,536)	-	(125,536)
Issuance of common stock	-	-	1,700,000	17	49,376	-	-	49,393
Issuance of common stock to directors	-	-	2,408	-	60	-	-	60
Exercise of common stock options	-	-	98,000	1	1,716	-	-	1,717
Comprehensive income:								
Net income	-	-	-	-	-	127,923	-	127,923
Net unrealized (loss) on securities	-	-	-	-	-	-	26,242	26,242
Reclassification of net realized (gain) on securities into earnings	-	-	-	-	-	-	(282)	(282)
Foreign currency translation	-	-	-	-	-	-	(26)	(26)
Net unrealized gain on derivatives designated as cash flow hedges	-	-	-	-	-	-	7,773	7,773
Reclassification of net realized (gain) on derivatives designated cash flow hedges into earnings	-	-	-	-	-	-	(3,287)	(3,287)
Total comprehensive income								158,343
Stockholders' equity - December 31, 2006	4,100,000	$ 102,500	45,713,817	$ 457	$ 833,887	$ (10,848)	$ 75,984	$ 1,001,980
Stockholders' equity - December 31, 2004	2,500,000	$ 62,500	39,859,481	$ 399	$ 676,015	$ (13,969)	$ 71,770	$ 796,715
Dividends declared	-	-	-	-	-	(116,221)	-	(116,221)
Issuance of common stock	-	-	3,300,000	33	96,449	-	-	96,482
Issuance of common stock to directors	-	-	2,008	-	67	-	-	67
Exercise of common stock options	-	-	751,920	7	11,687	-	-	11,694
Issuance of preferred stock	1,600,000	40,000	-	-	(1,483)	-	-	38,517
Comprehensive income:								
Net income	-	-	-	-	-	116,955	-	116,955
Net unrealized (loss) on securities	-	-	-	-	-	-	(67,077)	(67,077)
Reclassification of net realized (gain) on securities into earnings	-	-	-	-	-	-	(16,015)	(16,015)
Foreign currency translation	-	-	-	-	-	-	(1,089)	(1,089)
Reclassification of net realized foreign currency translation into earnings	-	-	-	-	-	-	(626)	(626)
Net unrealized gain on derivatives designated as cash flow hedges	-	-	-	-	-	-	56,426	56,426
Reclassification of net realized loss on derivatives designated as cash flow hedges into earnings	-	-	-	-	-	-	2,175	2,175
Total comprehensive income								90,749
Stockholders' equity - December 31, 2005	4,100,000	$ 102,500	43,913,409	$ 439	$ 782,735	$ (13,235)	$ 45,564	$ 918,003

Continued on next page.

NEWCASTLE INVESTMENT CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2006, 2005 and 2004
(dollars in thousands)

	Preferred Stock		Common Stock					
	Shares	Amount	Shares	Amount	Additional Paid in Capital	Dividends in Excess of Earnings	Accumulated Other Comp. Income	Total Stock-holders' Equity
Stockholders' equity - December 31, 2003	2,500,000	$ 62,500	31,374,833	$ 314	$ 451,806	$ (14,670)	$ 39,413	$ 539,363
Dividends declared	-	-	-	-	-	(97,714)	-	(97,714)
Issuance of common stock	-	-	8,375,000	84	222,721	-	-	222,805
Issuance of common stock to directors	-	-	2,148	-	60	-	-	60
Exercise of common stock options	-	-	107,500	1	1,428	-	-	1,429
Comprehensive income:								
Net income	-	-	-	-	-	98,415	-	98,415
Net unrealized gain on securities	-	-	-	-	-	-	34,088	34,088
Reclassification of net realized (gain) on securities into earnings	-	-	-	-	-	-	(14,574)	(14,574)
Foreign currency translation	-	-	-	-	-	-	1,984	1,984
Reclassification of net realized foreign currency translation into earnings	-	-	-	-	-	-	(1,478)	(1,478)
Net unrealized gain on derivatives designated as cash flow hedges	-	-	-	-	-	-	11,973	11,973
Reclassification of net unrealized loss on derivatives designated as cash flow hedges into earnings	-	-	-	-	-	-	364	364
Total comprehensive income								130,772
Stockholders' equity - December 31, 2004	2,500,000	$ 62,500	39,859,481	$ 399	$ 676,015	$ (13,969)	$ 71,770	$ 796,715

See notes to consolidated financial statements.

NEWCASTLE INVESTMENT CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOW
(dollars in thousands)

	Year Ended December 31,		
	2006	**2005**	**2004**
Cash Flows From Operating Activities			
Net income	$ 127,923	$ 116,955	$ 98,415
Adjustments to reconcile net income to net cash provided by operating activities (inclusive of amounts related to discontinued operations):			
Depreciation and amortization	1,085	818	2,253
Accretion of discount and other amortization	(15,365)	(2,645)	1,898
Equity in earnings of unconsolidated subsidiaries	(5,968)	(5,930)	(12,465)
Distributions of earnings from unconsolidated subsidiaries	5,968	5,930	12,465
Deferred rent	(1,274)	(2,539)	(1,380)
Gain on sale of investments	(13,359)	(20,811)	(22,029)
Unrealized gain on non-hedge derivatives and hedge ineffectiveness	(4,284)	(2,839)	(3,332)
Provision for credit losses	9,438	8,421	-
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	1,411,530	-	-
Non-cash directors' compensation	60	67	60
Change in			
Restricted cash	1,400	(7,980)	(8,137)
Receivables and other assets	(8,985)	218	(5,431)
Due to affiliates	4,682	(180)	6,518
Accrued expenses and other liabilities	10,430	9,278	21,520
Net cash provided by operating activities:	16,322	98,763	90,355
Cash Flows From Investing Activities			
Purchase of real estate securities	(1,295,067)	(1,463,581)	(1,426,762)
Proceeds from sale of real estate securities	318,007	60,254	193,246
Deposit on real estate securities (treated as a derivative)	-	(57,149)	(80,311)
Purchase of and advances on loans	(1,643,062)	(584,270)	(631,728)
Proceeds from settlement of loans	24,750	1,901	124,440
Repayments of loan and security principal	579,166	698,002	428,091
Margin received on derivative instruments	50,701	-	-
Return of margin on derivative instruments	(50,799)	-	-
Margin deposits on total rate of return swaps (treated as derivative instruments)	(55,922)	(53,518)	-
Return of margin deposits on total rate of return swaps (treated as derivative instruments)	81,619	-	-
Proceeds from termination of derivative instruments	16,426	1,338	-
Proceeds from sale of derivative instruments into Securitization Trust - Note 5	5,623	-	-
Payments on settlement of derivative instruments	-	(1,112)	-
Purchase and improvement of operating real estate	(1,585)	(182)	(141)
Proceeds from sale of operating real estate	-	52,333	71,871
Contributions to unconsolidated subsidiaries	(125)	-	(26,789)
Distributions of capital from unconsolidated subsidiaries	7,210	11,277	16,199
Payment of deferred transaction costs	-	(39)	(280)
Net cash used in investing activities	(1,963,058)	(1,334,746)	(1,332,164)

Continued on next page.

NEWCASTLE INVESTMENT CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOW
(dollars in thousands)

	Year Ended December 31,		
	2006	2005	2004
Cash Flows From Financing Activities			
Issuance of CBO bonds payable	807,464	880,570	859,719
Repayments of CBO bonds payable	(18,889)	(10,241)	(604)
Issuance of other bonds payable	631,988	246,547	-
Repayments of other bonds payable	(305,428)	(114,780)	(41,759)
Borrowings under notes payable	-	-	614,106
Repayments of notes payable	(131,575)	(391,559)	(119,407)
Borrowings under repurchase agreements	3,953,324	815,840	654,254
Repayments of repurchase agreements	(4,241,181)	(258,257)	(879,417)
Issuance of repurchase agreement subject to ABCP facility	1,143,749	-	-
Draws under credit facility	570,400	62,000	-
Repayments of credit facility	(496,600)	(42,000)	-
Issuance of junior subordinated notes payable	100,100	-	-
Issuance of common stock	50,014	97,680	222,805
Costs related to issuance of common stock	(581)	(1,198)	-
Exercise of common stock options	1,717	11,694	1,429
Issuance of preferred stock	-	40,000	-
Costs related to issuance of preferred stock	-	(1,483)	-
Dividends paid	(121,493)	(113,097)	(88,489)
Payment of deferred financing costs	(12,177)	(2,369)	(3,320)
Net cash provided by financing activities	1,930,832	1,219,347	1,219,317
Net Increase (Decrease) in Cash and Cash Equivalents	(15,904)	(16,636)	(22,492)
Cash and Cash Equivalents, Beginning of Period	21,275	37,911	60,403
Cash and Cash Equivalents, End of Period	$ 5,371	$ 21,275	$ 37,911
Supplemental Disclosure of Cash Flow Information			
Cash paid during the period for interest expense	$ 353,545	$ 213,070	$ 135,172
Cash paid during the period for income taxes	$ 244	$ 448	$ 2,639
Supplemental Schedule of Non-cash Investing and Financing Activities			
Common stock dividends declared but not paid	$ 31,543	$ 27,446	$ 24,912
Preferred stock dividends declared but not paid	$ 1,552	$ 1,606	$ 1,016
Deposits used in acquisition of real estate securities (treated as derivatives)	$ -	$ 82,334	$ 75,824
Foreclosure of loans	$ 14,780	$ -	$ -
Acquisition and financing of loans subject to future repurchase	$ 286,315	$ -	$ -
Retained bonds and equity in securitization	$ 96,058	$ -	$ -

See notes to consolidated financial statements.

1. ORGANIZATION

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.

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

Year	Shares Issued	Range of Issue Prices (1)	Net Proceeds (millions)
Formation	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
2006	1,800,408	$29.42	$51.2
December 31, 2006	45,713,817		
January 2007	2,420,000	$31.30	$75.0

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

Newcastle is organized and conducts its operations to qualify as a real estate investment trust ("REIT") under the Internal Revenue Code of 1986, as amended (the "Code"). As such, Newcastle will generally not be subject to U.S. federal corporate income tax on that portion of its net income that is distributed to stockholders if it distributes at least 90% of its REIT taxable income to its stockholders by prescribed dates and complies with various other requirements.

Newcastle is party to a management agreement (the "Management Agreement") with FIG LLC (the "Manager"), an affiliate of Fortress Investment Group LLC, 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. For a further discussion of the Management Agreement, see Note 10.

Approximately 2.9 million shares of Newcastle's common stock were held by the Manager, through its affiliates, and principals of Fortress at December 31, 2006. In addition, the Manager, through its affiliates, held options to purchase approximately 1.3 million shares of Newcastle's common stock at December 31, 2006.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

GENERAL

Basis of Accounting - The accompanying consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles ("GAAP"). The consolidated financial statements include the accounts of Newcastle and its consolidated subsidiaries. All significant intercompany transactions and balances have been eliminated. Newcastle consolidates those entities in which it has an investment of 50% or more and has control over significant operating, financial and investing decisions of the entity.

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, which became effective in the first quarter of 2004, 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 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. The application of FIN 46R did not result in a change in our accounting for any entities. Our CBO subsidiaries are considered VIEs of which we are the primary beneficiary.

For entities over which Newcastle exercises significant influence, but which do not meet the requirements for consolidation, Newcastle uses the equity method of accounting whereby it records its share of the underlying income of such entities. Newcastle owns an equity method investment in two limited liability companies (Note 3) which are investment companies and therefore maintain their financial records on a fair value basis. Newcastle has retained such accounting relative to its investments in such companies pursuant to the Emerging Issues Task Force ("EITF") Issue No. 85-12 "Retention of Specialized Accounting for Investments in Consolidation." In addition, Newcastle owns equity method investments in two entities which issued trust preferred securities and asset backed commercial paper (Note 8).

Risks and Uncertainties ¾ In the normal course of business, Newcastle encounters primarily two significant types of economic risk: credit and market. Credit risk is the risk of default on Newcastle's securities, loans, derivatives, and leases that results from a borrower's, derivative counterparty's or lessee's inability or unwillingness to make contractually required payments. Market risk reflects changes in the value of investments in securities, loans and derivatives or in real estate due to changes in interest rates, spreads or other market factors, including the value of the collateral underlying loans and securities and the valuation of real estate held by Newcastle. Management believes that the carrying values of its investments are reasonable taking into consideration these risks along with estimated collateral values, payment histories, and other borrower information.

Additionally, Newcastle is subject to significant tax risks. If Newcastle were to fail to qualify as a REIT in any taxable year, Newcastle would be subject to U.S. federal corporate income tax (including any applicable alternative minimum tax), which could be material. In addition, if Newcastle's predecessor, Newcastle Investment Holdings Corp. ("Holdings"), failed to qualify as a REIT and Newcastle is treated as a successor to Holdings, this could cause Newcastle to likewise fail to qualify as a REIT. Unless entitled to relief under certain statutory provisions, Newcastle would also be disqualified from treatment as a REIT for the four taxable years following the year during which qualification is lost.

Use of Estimates ¾ The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Comprehensive Income ¾ Comprehensive income is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances, excluding those resulting from investments by and distributions to owners. For Newcastle's purposes, comprehensive income represents net income, as presented in the statements of income, adjusted for unrealized gains or losses on securities available for sale and derivatives designated as cash flow hedges and net foreign currency translation adjustments. The following table summarizes our accumulated other comprehensive income:

	December 31,	
	2006	2005
Net unrealized gains on securities	$ 42,742	$ 16,782
Net unrealized gains on derivatives designated as cash flow hedges	31,224	26,738
Net foreign currency translation adjustments	2,018	2,044
Accumulated other comprehensive income	$ 75,984	$ 45,564

REVENUE RECOGNITION

Real Estate Securities and Loans Receivable ¾ Newcastle invests in securities, including commercial mortgage backed securities, senior unsecured debt issued by property REITS, real estate related asset backed securities and agency residential mortgage backed securities. Newcastle also invests in loans, including real estate related loans, commercial mortgage loans, residential mortgage loans, manufactured housing loans and subprime mortgage loans. Newcastle determines at acquisition whether loans will be aggregated into pools based on common risk characteristics (credit quality, loan type, and date of origination or acquisition); loans aggregated into pools are accounted for as if each pool were a single loan. Loans receivable are presented in the consolidated balance sheet net of any unamortized discount (or gross of any unamortized premium) and an allowance for loan losses. Discounts or premiums are accreted into interest income on an effective yield or “interest” method, based upon a comparison of actual and expected cash flows, through the expected maturity date of the security or loan. Depending on the nature of the investment, changes to expected cash flows may result in a prospective change to yield or a retrospective change which would include a catch up adjustment. For loans acquired at a discount for credit quality, the difference between contractual cash flows and expected cash flows at acquisition is not accreted (nonaccretable difference). Income is not accrued on non-performing securities or loans; cash received on such securities or loans is treated as income to the extent of interest previously accrued. Interest income with respect to non-discounted securities or loans is recognized on an accrual basis. Deferred fees and costs, if any, are recognized as interest income over the terms of the securities or loans using the interest method. Upon settlement of securities and loans, the excess (or deficiency) of net proceeds over the net carrying value of such security or loan is recognized as a gain (or loss) in the period of settlement. Interest income includes prepayment penalties received of $5.9 million, $3.2 million and $0.6 million in 2006, 2005 and 2004, respectively.

Impairment of Securities and Loans ¾ Newcastle continually evaluates securities and loans for impairment. This evaluation includes the following, as applicable: (i) review of the credit of the issuer or the borrower, (ii) review of the credit rating of the security, (iii) review of the key terms of the security or loan, (iv) review of the performance of the loan or underlying loans, including debt service coverage and loan to value ratios, (v) analysis of the value of the collateral for the loan or underlying loans, (vi) analysis of the effect of local, industry and broader economic factors, and (vii) analysis of trends in defaults and loss severities for similar loans. Securities and loans are considered to be impaired, for financial reporting purposes, when it is probable that Newcastle will be unable to collect all principal or interest when due according to the contractual terms of the original agreements, or, for securities or loans purchased at a discount for credit quality or that represent beneficial interests in securitizations, when Newcastle determines that it is probable that it will be unable to collect as anticipated. For loans purchased at a discount for credit quality, if Newcastle determines that it is probable that it will collect more than previously anticipated, the yield accrued on such loan or security is adjusted upward, on a prospective basis. Upon determination of impairment, Newcastle establishes specific valuation allowances for loans or records a direct write down for securities, through provisions for losses, based on the estimated fair value of the underlying collateral using a discounted cash flow analysis or based on observable market value. Newcastle also establishes allowances for estimated unidentified incurred losses on pools of loans. The allowance for each security or loan is maintained at a level believed adequate by management to absorb probable losses, based on periodic reviews of actual and expected losses. It is Newcastle’s policy to establish an allowance for uncollectible interest on performing securities or loans that are past due more than 90 days or sooner when, in the judgment of management, the probability of collection of interest is deemed to be insufficient to warrant further accrual. Upon such a determination, those loans are deemed to be non-performing. Actual losses may differ from Newcastle’s estimate.

EXPENSE RECOGNITION

Interest Expense ¾ Newcastle finances its investments using both fixed and floating rate debt, including securitizations, loans, repurchase agreements, and other financing vehicles. Certain of this debt has been issued at discounts. Discounts are accreted into interest expense on the interest method through the expected maturity date of the financing.

Deferred Costs and Interest Rate Cap Premiums ¾ Deferred costs consist primarily of costs incurred in obtaining financing which are amortized into interest expense over the term of such financing using the interest method. Interest rate cap premiums, which are included in Derivative Assets, are amortized as described below.

Derivatives and Hedging Activities ¾ All derivatives are recognized as either assets or liabilities on the balance sheet and measured at fair value. Fair value adjustments affect either stockholders' equity or net income depending on whether the derivative instrument qualifies as a hedge for accounting purposes and, if so, the nature of the hedging activity. For those derivative instruments that are designated and qualify as hedging instruments, Newcastle designates the hedging instrument, based upon the exposure being hedged, as either a cash flow hedge, a fair value hedge or a hedge of a net investment in a foreign operation.

Derivative transactions are entered into by Newcastle solely for risk management purposes, except for real estate securities portfolio deposits as described in Note 4 and the total rate of return swaps described in Note 5. Such total rate of return swaps are essentially financings of certain reference assets which are treated as derivatives for accounting purposes. The decision of whether or not a given transaction/position (or portion thereof) is hedged is made on a case-by-case basis, based on the risks involved and other factors as determined by senior management, including restrictions imposed by the Code among others. In determining whether to hedge a risk, Newcastle may consider whether other assets, liabilities, firm commitments and anticipated transactions already offset or reduce the risk. All transactions undertaken as hedges are entered into with a view towards minimizing the potential for economic losses that could be incurred by Newcastle. Generally, all derivatives entered into are intended to qualify as hedges under GAAP, unless specifically stated otherwise. To this end, terms of hedges are matched closely to the terms of hedged items.

<u>Description of the risks being hedged</u>

1) Interest rate risk, existing debt obligations - Newcastle generally hedges the risk of interest rate fluctuations with respect to its borrowings, regardless of the form of such borrowings, which require payments based on a variable interest rate index. Newcastle generally intends to hedge only the risk related to changes in the benchmark interest rate (LIBOR or a Treasury rate). In order to reduce such risks, Newcastle may enter into swap agreements whereby Newcastle would receive floating rate payments in exchange for fixed rate payments, effectively converting the borrowing to fixed rate. Newcastle may also enter into cap agreements whereby, in exchange for a premium, Newcastle would be reimbursed for interest paid in excess of a certain cap rate.

2) Interest rate risk, anticipated transactions - Newcastle may hedge the aggregate risk of interest rate fluctuations with respect to anticipated transactions, primarily anticipated borrowings. The primary risk involved in an anticipated borrowing is that interest rates may increase between the date the transaction becomes probable and the date of consummation. Newcastle generally intends to hedge only the risk related to changes in the benchmark interest rate (LIBOR or a Treasury rate). This is generally accomplished through the use of interest rate swaps.

3) Interest rate risk, fair value of investments - Newcastle occasionally hedges the fair value of investments acquired outside of its warehouse agreements (Note 4) prior to such investments being included in a CBO financing (Note 8). The primary risk involved is the risk that the fair value of such an investment will change between the acquisition date and the date the terms of the related financing are “locked in.” Newcastle generally intends to hedge only the risk related to changes in the benchmark interest rate (LIBOR or a Treasury rate). This is generally accomplished through the use of interest rate swaps.

Cash flow hedges

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

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

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

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

Fair Value Hedges

Any unrealized gains or losses, as well as net payments received or made, on these derivative instruments are recorded currently in income, as are any unrealized gains or losses on the associated hedged items related to changes in interest rates.

Non-Hedge Derivatives

With respect to interest rate swaps and caps that have not been designated as hedges, any net payments under, or fluctuations in the fair value of, such swaps and caps has been recognized currently in Other Income.

Classification

Newcastle's derivatives are recorded on its balance sheet as follows (excluding the real estate securities portfolio deposit, which is reported separately):

	December 31, 2006	December 31, 2005
Derivative Assets		
Interest rate caps (A)	$ 1,262	$ 2,145
Interest rate swaps (A)	59,551	56,829
Total rate of return swaps	1,288	3,096
Non-hedge derivatives (B)	783	1,764
	$ 62,884	$ 63,834
Derivative Liabilities		
Interest rate swaps (A)	$ 16,664	$ 15,659
Interest (receivable) payable	(92)	1,059
Non-hedge derivatives (B)	1,143	1,674
	$ 17,715	$ 18,392

(A) Treated as hedges

(B) Interest rate swaps and caps

The following table summarizes financial information related to derivatives (excluding the real estate securities portfolio deposit and total rate of return swaps, which are reported separately) :

	December 31, 2006	**December 31, 2005**
Cash flow hedges		
Notional amount		
Interest rate cap agreements	$ 334,971	$ 342,351
Interest rate swap agreements	3,937,544	2,941,625
Deferred hedge gain (loss) related to anticipated financings, net of amortization	(1,585)	(3,536)
Deferred hedge gain (loss) related to dedesignation, net of amortization	(2,554)	(202)
Expected reclassification of deferred hedges from AOCI into earnings over the next 12 months	(1,251)	(1,002)
Fair value hedges		
Notional amount	5,575	2,127
Deferred hedge gain (loss) related to lease payments, net of amortization	-	(129)
Non-hedge Derivatives		
Notional amount of interest rate cap and swap agreements	147,500	166,700

	Year Ended December 31, 2006	**2005**	**2004**
Cash flow hedges			
Gain (loss) on the ineffective portion	$ 49	$ 164	$ (100)
Gain (loss) immediately recognized at dedesignation	5,133	342	-
Fair value hedges			
Gain (loss) on the effective portion (A)	(333)	7	(1)
Gain (loss) on the ineffective portion	(22)	-	-
Non-hedge derivatives gain (loss)	6,178	976	-

(A) Offset by the unrealized gain (loss) on the associated hedged items which is recognized in earnings.

Newcastle's derivative financial instruments contain credit risk to the extent that its bank counterparties may be unable to meet the terms of the agreements. Newcastle minimizes such risk by limiting its counterparties to highly rated major financial institutions with good credit ratings. In addition, the potential risk of loss with any one party resulting from this type of credit risk is monitored. Management does not expect any material losses as a result of default by other parties. Newcastle does not require collateral; however, Newcastle does call margin from its counterparties when applicable.

Management Fees and Incentive Compensation to Affiliate ¾ These represent amounts due to the Manager pursuant to the Management Agreement. For further information on the Management Agreement, see Note 10.

BALANCE SHEET MEASUREMENT

Investment in Real Estate Securities ¾ Newcastle has classified its investments in securities as available for sale. Securities available for sale are carried at market value with the net unrealized gains or losses reported as a separate component of accumulated other comprehensive income. At disposition, the net realized gain or loss is determined on the basis of the cost of the specific investments and is included in earnings. Unrealized losses on securities are charged to earnings if they reflect a decline in value that is other than temporary. A decline in value is considered other than temporary if either (a) it is deemed probable that Newcastle will be unable to collect all amounts anticipated to be collected at acquisition, or (b) Newcastle does not have the ability and intent to hold such investment until a forecasted market price recovery.

Investment in Loans ¾ Loans receivable are presented net of any unamortized discount (or gross of any unamortized premium), including any fees received, and an allowance for loan losses. All of Newcastle's loans receivable are classified as held for investment.

Investment in Operating Real Estate ¾ Operating real estate is recorded at cost less accumulated depreciation. Depreciation is computed on a straight-line basis. Buildings are depreciated over 40 years. Major improvements are capitalized and depreciated over their estimated useful lives. Fees and costs incurred in the successful negotiation of leases are deferred and amortized on a straight-line basis over the terms of the respective leases. Expenditures for repairs and maintenance are expensed as incurred. Newcastle reviews its real estate assets for impairment annually or whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. Long-lived assets to be disposed of by sale, which meet certain criteria, are reclassified to Real Estate Held for Sale and measured at the lower of their carrying amount or fair value less costs of sale. The results of operations for such an asset, assuming such asset qualifies as a "component of an entity" as defined, are retroactively reclassified to Income (Loss) from Discontinued Operations for all periods presented.

Foreign Currency Investments ¾ Assets and liabilities relating to foreign investments are translated using exchange rates as of the end of each reporting period. The results of Newcastle's foreign operations are translated at the weighted average exchange rate for each reporting period. Translation adjustments are included as a component of accumulated other comprehensive income until realized.

Cash and Cash Equivalents and Restricted Cash ¾ Newcastle considers all highly liquid short term investments with maturities of 90 days or less when purchased to be cash equivalents. Substantially all amounts on deposit with major financial institutions exceed insured limits. Restricted cash consisted of:

	December 31,	
	2006	2005
Held in CBO structures pending reinvestment (Note 8)	$ 123,886	$ 173,438
Total rate of return swap margin accounts	46,760	72,427
Bond sinking funds	101	9,532
Trustee accounts	10,031	9,047
Reserve accounts	1,539	2,558
Derivative margin accounts	1,794	1,908
Restricted property operating accounts	58	-
	$ 184,169	$ 268,910

Stock Options ¾ Newcastle accounts for stock options granted in accordance with SFAS No. 123, "Accounting for Stock-Based Compensation" as revised in December 2004 and amended by EITF Issue No. 96-18 "Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Loans or Services." The fair value of the options issued as compensation to the Manager for its successful efforts in raising capital for Newcastle in 2006, 2005 and 2004 was recorded as an increase in stockholders' equity with an offsetting reduction of capital proceeds received. Options granted to Newcastle's directors were accounted for using the fair value method.

Preferred Stock ¾ In March 2003, Newcastle issued 2.5 million shares ($62.5 million face amount) of its 9.75% Series B Cumulative Redeemable Preferred Stock (the "Series B Preferred") for net proceeds of approximately $60.1 million. In October 2005, Newcastle issued 1.6 million shares ($40.0 million face amount) of its 8.05% Series C Cumulative Redeemable Preferred Stock (the "Series C Preferred") for net proceeds of approximately $38.5 million. The Series B Preferred and Series C Preferred are non-voting, have a $25 per share liquidation preference, no maturity date and no mandatory redemption. Newcastle has the option to redeem the Series B Preferred beginning in March 2008 and the Series C Preferred beginning in October 2010 at their face amount. If the Series C Preferred ceases to be listed on the NYSE or the AMEX, or quoted on the NASDAQ, and Newcastle is not subject to the reporting requirements of the Exchange Act, Newcastle has the option to redeem the Series C Preferred at their face amount and, during such time any shares of Series C Preferred are outstanding, the dividend will increase to 9.05% per annum.

In connection with the issuance of the Series B Preferred Stock and Series C Preferred Stock, Newcastle incurred approximately $2.4 million and $1.5 million of costs, respectively, which were netted against the proceeds of such offerings. If either series of preferred stock were redeemed, the related costs would be recorded as an adjustment to income available for common stockholders at that time.

Accretion of Discount and Other Amortization ¾ As reflected on the Consolidated Statements of Cash Flow, this item is comprised of the following:

	2006	2005	2004
Accretion of net discount on securities and loans	$ (27,657)	$ (13,432)	$ (4,282)
Amortization of net discount on debt obligations	7,328	4,574	4,132
Amortization of deferred financing costs and interest rate cap premiums	4,434	4,417	3,979
Amortization of net deferred hedge gains and losses - debt	401	1,587	(2,118)
Amortization of deferred hedge loss - leases	129	209	187
	$ (15,365)	$ (2,645)	$ 1,898

Securitization of Subprime Mortgage Loans ¾ Newcastle's accounting policy for its securitization of subprime mortgage loans is disclosed in Note 5.

Accounting Treatment for Certain Investments Financed with Repurchase Agreements **¾** Newcastle owned $305.7 million of assets purchased from particular counterparties which are financed via $243.7 million of repurchase agreements with the same counterparties at December 31, 2006. Currently, Newcastle records such assets and the related financings gross on its balance sheet, and the corresponding interest income and interest expense gross on its 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 Newcastle, based on their "continuing involvement" with such investments. The result is that Newcastle may be precluded from presenting the assets gross on its balance sheet as it currently does, and may instead be required to treat its 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 Newcastle to hedge its 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 Newcastle's financial statements. Newcastle's cash flows, its liquidity and its ability to pay a dividend would be unchanged, and Newcastle does not believe its taxable income would be affected. Newcastle's 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. Management understands that this issue has been submitted to accounting standard setters for resolution. If Newcastle were to change its current accounting treatment for these transactions, its total assets and total liabilities would each be reduced by $244.3 million and $287.9 million at December 31, 2006 and 2005, respectively.

Recent Accounting Pronouncements ¾ In June 2006, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes, as interpretation of FASB Statement No. 109" ("FIN 48"). FIN 48 requires companies to recognize the tax benefits of uncertain tax positions only where the position is "more likely than not" to be sustained assuming examination by tax authorities. The tax benefit recognized is the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. FIN 48 is effective for fiscal years beginning after December 15, 2006. The adoption of FIN48 is not expected to have a material impact on Newcastle's financial condition or results of operations.

In February 2006, the FASB issued Statement of Financial Accounting Standards ("SFAS") No. 155, "Accounting for Certain Hybrid Financial Instruments", which amends SFAS 133, "Accounting for Derivative Instruments and Hedging Activities," and SFAS 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities". SFAS 155 provides, among other things, that (i) for embedded derivatives which would otherwise be required to be bifurcated from their host contracts and accounted for at fair value in accordance with SFAS 133 an entity may make an irrevocable election, on an instrument-by-instrument basis, to measure the hybrid financial instrument at fair value in its entirety, with changes in fair value recognized in earnings and (ii) concentrations of credit risk in the form of subordination are not considered embedded derivatives. SFAS 155 is effective for all financial instruments acquired, issued or subject to remeasurement after the beginning of an entity's first fiscal year that begins after September 15, 2006. Upon adoption, differences between the total carrying amount of the individual components of an existing bifurcated hybrid financial instrument and the fair value of the combined hybrid financial instrument should be recognized as a cumulative effect adjustment to beginning retained earnings. Prior periods are not restated. The adoption of SFAS 155 is not expected to have a material impact on Newcastle's financial condition or results of operations.

In December 2004, the FASB issued SFAS No. 123(R), "Share-Based Payment", which requires all equity-based payments to employees and non-employees to be recognized using a fair value based method. However, SFAS 123(R) does not change the measurement method for equity-based payments to non-employees which were already measured at fair value. On January 1, 2006, Newcastle adopted SFAS No. 123(R) using the modified prospective method and therefore prior period amounts will not be restated. The adoption of SFAS 123(R) did not have a material impact on Newcastle's financial condition or results of operations.

In September 2006, the FASB cleared Statement of Position No. 71, "Clarification of the Scope of the Audit and Accounting Guide *Investment Companies* and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies" ("SOP 71") for issuance. SOP 71 addresses whether the accounting principles of the Audit and Accounting Guide for Investment Companies may be applied to an entity by clarifying the definition of an investment company and whether those accounting principles may be retained by a parent company in consolidation or by an investor in the application of the equity method of accounting. SOP 71 applies to the later of the (i) reporting periods beginning on or after December 15, 2007 or (ii) the first permitted early adoption date of the FASB's proposed fair value option statement. Newcastle is currently evaluating the potential impact on adoption of SOP 71.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements". SFAS 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS 157 applies to reporting periods beginning after November 15, 2007. The adoption of SFAS 157 is not expected to have a material impact on Newcastle's financial condition or results of operations.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities." SFAS 159 permits entities to choose to measure many financial instruments, and certain other items, at fair value. SFAS 159 applies to reporting periods beginning after November 15, 2007. Newcastle is currently evaluating the potential impact on adoption of SFAS 159.

3. INFORMATION REGARDING BUSINESS SEGMENTS AND UNCONSOLIDATED SUBSIDIARIES

Newcastle conducts its business through three primary segments: real estate securities and real estate related loans, residential mortgage loans and operating real estate. Details of Newcastle's investments in such segments can be found in Notes 4, 5 and 6.

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.

The unallocated portion consists primarily of interest on short term investments, general and administrative expenses, interest expense on the credit facility and junior subordinated notes payable and management fees and incentive compensation pursuant to the Management Agreement.

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
December 31, 2006 and the Year then Ended					
Gross revenues	$ 441,965	$ 105,621	$ 5,117	$ (94)	$ 552,609
Operating expenses	(2,961)	(17,844)	(4,059)	(30,659)	(55,523)
Operating income (loss)	439,004	87,777	1,058	(30,753)	497,086
Interest expense	(296,368)	(66,181)	-	(11,720)	(374,269)
Depreciation and amortization	-	-	(812)	(273)	(1,085)
Equity in earnings of unconsolidated subsidiaries (A)	3,412	-	2,550	6	5,968
Income (loss) from continuing operations	146,048	21,596	2,796	(42,740)	127,700
Income (loss) from discontinued operations	-	-	223	-	223
Net income (loss)	146,048	21,596	3,019	(42,740)	127,923
Preferred dividends	-	-	-	(9,314)	(9,314)
Income (loss) available for common stockholders	$ 146,048	$ 21,596	$ 3,019	$ (52,054)	$ 118,609
Revenue derived from non-US sources:					
Canada	$ -	$ -	$ 3,671	$ -	$ 3,671
Total assets	$ 7,366,684	$ 1,179,547	$ 48,518	$ 9,643	$ 8,604,392
Long-lived assets outside the US:					
Canada	$ -	$ -	$ 16,553	$ -	$ 16,553
December 31, 2005 and the Year then Ended					
Gross revenues	$ 321,889	$ 48,844	$ 6,772	$ 708	$ 378,213
Operating expenses	(4,163)	(10,384)	(2,456)	(24,885)	(41,888)
Operating income (loss)	317,726	38,460	4,316	(24,177)	336,325
Interest expense	(196,026)	(29,754)	(251)	(415)	(226,446)
Depreciation and amortization	-	-	(528)	(113)	(641)
Equity in earnings of unconsolidated subsidiaries (A)	3,328	-	2,281	-	5,609
Income (loss) from continuing operations	125,028	8,706	5,818	(24,705)	114,847
Income (loss) from discontinued operations	-	-	2,108	-	2,108
Net income (loss)	125,028	8,706	7,926	(24,705)	116,955
Preferred dividends	-	-	-	(6,684)	(6,684)
Income (loss) available for common stockholders	$ 125,028	$ 8,706	$ 7,926	$ (31,389)	$ 110,271
Revenue derived from non-US sources:					
Canada	$ -	$ -	$ 12,157	$ -	$ 12,157
Total assets	$ 5,544,818	$ 606,320	$ 36,306	$ 22,255	$ 6,209,699
Long-lived assets outside the US:					
Canada	$ -	$ -	$ 16,673	$ -	$ 16,673

	Real Estate Securities and Real Estate Related Loans	Residential Mortgage Loans	Operating Real Estate	Unallocated	Total
December 31, 2004 and the Year then Ended					
Gross revenues	$ 225,236	$ 19,135	$ 4,745	$ 553	$ 249,669
Operating expenses	(828)	(2,319)	(2,678)	(22,983)	(28,808)
Operating income (loss)	224,408	16,816	2,067	(22,430)	220,861
Interest expense	(124,930)	(10,863)	(605)	-	(136,398)
Depreciation and amortization	-	-	(445)	(6)	(451)
Equity in earnings of unconsolidated subsidiaries (A)	3,767	-	6,190	-	9,957
Income (loss) from continuing operations	103,245	5,953	7,207	(22,436)	93,969
Income (loss) from discontinued operations	-	-	4,446	-	4,446
Net income (loss)	103,245	5,953	11,653	(22,436)	98,415
Preferred dividends	-	-	-	(6,094)	(6,094)
Income (loss) available for common stockholders	$ 103,245	$ 5,953	$ 11,653	$ (28,530)	$ 92,321
Revenue derived from non-US sources:					
Canada	$ -	$ -	$ 13,203	$ -	$ 13,203
Belgium	$ -	$ -	$ 10,602	$ -	$ 10,602
Total assets	$ 4,136,203	$ 658,643	$ 108,322	$ 29,552	$ 4,932,720
Long-lived assets outside the US:					
Canada	$ -	$ -	$ 57,193	$ -	$ 57,193
Belgium	$ -	$ -	$ 12,376	$ -	$ 12,376

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

Unconsolidated Subsidiaries
Newcastle has four unconsolidated subsidiaries which it accounts for under the equity method.

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

	Operating Real Estate	Real Estate Loan
Balance at December 31, 2004	$ 17,778	$ 23,452
Contributions to unconsolidated subsidiaries	-	-
Distributions from unconsolidated subsidiaries	(8,229)	(8,978)
Equity in earnings of unconsolidated subsidiaries	2,602	3,328
Balance at December 31, 2005	$ 12,151	$ 17,802
Contributions to unconsolidated subsidiaries	-	-
Distributions from unconsolidated subsidiaries	(2,173)	(11,041)
Equity in earnings of unconsolidated subsidiaries	2,550	3,488
Balance at December 31, 2006	$ 12,528	$ 10,249

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

	Operating Real Estate (A) (C)			Real Estate Loan (B)		
	December 31,			December 31,		
	2006	2005	2004	2006	2005	2004
Assets	$ 78,381	$ 77,758	$ 89,222	$ 20,615	$ 35,806	$ 47,170
Liabilities	(52,856)	(53,000)	(53,000)	-	-	-
Minority interest	(470)	(455)	(666)	(116)	(202)	(266)
Equity	$ 25,055	$ 24,303	$ 35,556	$ 20,499	$ 35,604	$ 46,904
Equity held by Newcastle	$ 12,528	$ 12,151	$ 17,778	$ 10,249	$ 17,802	$ 23,452
	2006	2005	2004	2006	2005	2004
Revenues	$ 8,626	$ 10,196	$ 25,011	$ 7,048	$ 6,738	$ 7,852
Expenses	(3,430)	(4,896)	(7,159)	(32)	(42)	(111)
Minority interest	(96)	(97)	(328)	(40)	(39)	(44)
Net income	$ 5,100	$ 5,203	$ 17,524	$ 6,976	$ 6,657	$ 7,697
Newcastle's equity in net income	$ 2,550	$ 2,602	$ 8,698	$ 3,488	$ 3,328	$ 3,767

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

(A) Included in the operating real estate segment.

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

(C) With respect to the operating real estate subsidiary, no income was recorded from the company holding assets available for sale in 2006 and $0.8 million and $7.2 million was derived from holding assets available for sale in 2005 and 2004, respectively. The remaining of Newcastle's equity in net income was derived from the company holding assets for investment in 2006, 2005 and 2004, respectively. As of December 31, 2006 and 2005, all of the equity held by Newcastle related to the company holding assets for investment. This subsidiary is more fully described below.

Operating Real Estate Subsidiary

In March 2004 Newcastle purchased a 49% interest in a portfolio of convenience and retail gas stores located throughout the southeastern and southwestern regions of the U.S. The properties are subject to a sale-leaseback arrangement under long term triple net leases with a 15 year minimum term. Circle K Stores Inc. ("Tenant"), an indirect wholly owned subsidiary of Alimentation Couche-Tard Inc. ("ACT"), is the counterparty under the leases. ACT guarantees the obligations of Tenant under the leases. Newcastle structured this transaction through a joint venture in two limited liability companies with a private investment fund managed by an affiliate of its manager, pursuant to which such affiliate co-invested on equal terms. One company held assets available for sale, the last of which was sold in September 2005, and one holds assets for investment. In October 2004, the investment's initial financing was refinanced with a nonrecourse term loan ($52.9 million outstanding at December 31, 2006), which bears interest at a fixed rate of 6.04%. The required payments under the loan consist of interest only during the first two years, followed by a 25-year amortization schedule with a balloon payment due in October 2014. Newcastle has no additional capital commitment to the limited liability companies.

Real Estate Loan Subsidiary

In November 2003, Newcastle and a private investment fund managed by an affiliate of the Manager co-invested and each indirectly own an approximately 38% interest in DBNC Peach Manager LLC, a limited liability company that has acquired a pool of franchise loans collateralized by fee and leasehold interests and other assets from a third party financial institution. The remaining approximately 24% interest in the limited liability company is owned by the above-referenced third party financial institution. Newcastle has no additional capital commitment to the limited liability company.

Each of these limited liability companies is an investment company and therefore maintains its financial records on a fair value basis. Newcastle has retained such accounting relative to its investment in such limited liability companies, which are accounted for under the equity method at fair value.

Trust Preferred Subsidiary

As of December 31, 2006, Newcastle's investment in the Trust Preferred Subsidiary was $0.1 million. For Information regarding the trust preferred subsidiary, which is a financing subsidiary with no material net income or cash flow, see Note 8.

ABCP Subsidiary

As of December 31, 2006, Newcastle had a deminimus investment in this subsidiary. For information regarding the ABCP Subsidiary, which is a financing subsidiary with no material net income or net cash flow, see Note 8.

4. REAL ESTATE SECURITIES

The following is a summary of Newcastle's real estate securities at December 31, 2006 and 2005, all of which are classified as available for sale and are therefore marked to market through other comprehensive income.

December 31, 2006

			Gross Unrealized				Weighted Average			
Asset Type	Current Face Amount	Amortized Cost Basis	Gains	Losses	Carrying Value	Number of Securities	S&P Equivalent Rating	Coupon	Yield	Maturity (Years)
CMBS-Conduit	$ 1,469,298	$ 1,421,069	$ 41,465	$ (9,745)	$ 1,452,789	202	BBB	5.84%	6.51%	6.93
CMBS-Large Loan	714,617	712,655	6,991	(421)	719,225	53	BBB-	6.85%	7.02%	2.62
CMBS-CDO	23,500	20,820	1,265	(127)	21,958	2	BB	9.47%	12.03%	7.68
CMBS- B-Note	282,677	270,257	6,141	(208)	276,190	41	BB	6.85%	7.51%	6.02
Unsecured REIT Debt	1,004,540	1,017,280	18,923	(11,163)	1,025,040	101	BBB-	6.36%	6.06%	6.17
ABS-Manufactured Housing	80,839	76,347	1,744	(391)	77,700	9	BBB-	6.68%	7.79%	6.54
ABS-Home Equity	729,292	713,135	4,677	(7,481)	710,331	124	BBB+	7.15%	7.89%	2.70
ABS-Franchise	76,777	76,264	1,713	(1,270)	76,707	22	BBB	7.28%	8.21%	4.80
Agency RMBS	1,177,779	1,182,946	2,144	(8,732)	1,176,358	35	AAA	5.22%	5.19%	4.27
Subtotal/Average (A)	5,559,319	5,490,773	85,063	(39,538)	5,536,298	589	BBB+	6.20%	6.50%	5.04
Residual interest (B)	44,930	44,930	-	-	44,930	1	NR	0.00%	18.77%	2.52
Total/Average	$ 5,604,249	$ 5,535,703	$ 85,063	$ (39,538)	$ 5,581,228	590	BBB+	6.15%	6.60%	5.02

(A) The total current face amount of fixed rate securities was $4.4 billion, and of floating rate securities was $1.2 billion.
(B) Represents the equity from the Securitization Trust as described in Note 5. This security has been treated as part of the residential mortgage loan segment - see Note 3. 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 years ended December 31, 2006, 2005, or 2004. 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 December 31, 2006. Newcastle has performed credit analyses (described in Note 2) 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.

			Gross Unrealized				Weighted Average			
	Current Face Amount	Amortized Cost Basis	Gains	Losses	Carrying Value	Number of Securities	S&P Equivalent Rating	Coupon	Yield	Maturity (Years)
Securities in an Unrealized Loss Position										
Less Than Twelve Months	$ 700,782	$ 683,237	$ -	$ (8,731)	$ 674,506	84	A-	6.55%	7.28%	4.11
Twelve or More Months	1,600,903	1,622,047	-	(30,807)	1,591,240	185	A	5.56%	5.29%	5.46
Total	$ 2,301,685	$ 2,305,284	$ -	$ (39,538)	$ 2,265,746	269	A	5.86%	5.88%	5.05

December 31, 2005

			Gross Unrealized				Weighted Average			
Asset Type	Current Face Amount	Amortized Cost Basis	Gains	Losses	Carrying Value	Number of Securities	S&P Equivalent Rating	Coupon	Yield	Maturity (Years)
CMBS-Conduit	$ 1,455,345	$ 1,397,868	$ 26,367	$ (26,906)	$ 1,397,329	197	BBB-	5.84%	6.61%	7.87
CMBS-Large Loan	578,331	575,444	9,096	(377)	584,163	61	BBB-	6.64%	6.75%	2.10
CMBS- B-Note	180,201	176,228	4,732	(329)	180,631	32	BBB-	6.62%	6.95%	5.97
Unsecured REIT Debt	916,262	931,777	20,804	(9,835)	942,746	99	BBB-	6.34%	5.96%	6.95
ABS-Manufactured Housing	178,915	162,410	2,422	(1,766)	163,066	10	A-	7.12%	8.65%	6.64
ABS-Home Equity	525,004	523,363	3,429	(2,315)	524,477	89	B	6.03%	6.10%	3.16
ABS-Franchise	70,837	69,732	1,113	(1,223)	69,622	18	BBB+	6.66%	8.12%	5.14
Agency RMBS	697,530	700,912	145	(8,572)	692,485	19	AAA	4.76%	4.67%	4.90
Total/Average (A)	$ 4,602,425	$ 4,537,734	$ 68,108	$ (51,323)	$ 4,554,519	525	BBB+	5.99%	6.25%	5.81

(A) The total current face amount of fixed rate securities was $3.6 billion, and of floating rate securities was $1.0 billion.

As of December 31, 2006, 2005 and 2004, Newcastle has no loss allowance recorded on its real estate securities.

During 2006 and 2005, Newcastle recorded gross realized gains of approximately $9.2 million and $24.0 million, respectively, and gross realized losses of approximately $2.1 million and $3.4 million, respectively, related to the sale of real estate securities.

The securities are encumbered by the CBO bonds payable (Note 8) at December 31, 2006.

As of December 31, 2006 and 2005, Newcastle had $123.9 million and $173.4 million of restricted cash, respectively, held in CBO financing structures pending its investment in real estate securities and loans.

Newcastle may enter into short term warehouse agreements pursuant to which it makes deposits with major investment banks for the right to purchase commercial mortgage backed securities, unsecured REIT debt, real estate related loans and real estate related asset backed securities prior to their being financed with CBOs. This type of warehouse agreement is treated as a non-hedge derivative for accounting purposes and is therefore marked to market through current income. The cost to Newcastle if the related CBO is not consummated is limited, except where the non-consummation results from Newcastle’s gross negligence, willful misconduct or breach of contract, to payment of the Net Loss, if any, as defined, up to the related deposit, less any Excess Carry Amount, as defined, earned on such deposit. No income was recorded in 2006 and the income recorded on these agreements was approximately $2.4 million and $3.1 million in 2005 and 2004, respectively.

5. 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. The loans contain various terms, including fixed and floating rates, self-amortizing and interest only. They are generally subject to prepayment.

	December 31,				December 31, 2006			
	2006	2005	2006	2005				
Loan Type	Current Face Amount		Carrying Value (D)		Loan Count	Wtd. Avg. Yield	Weighted Average Maturity (Years) (E)	Delinquent Carrying Amount (F)
B-Notes	$ 248,240	$ 72,173	$ 246,798	$ 72,520	9	7.98%	2.71	$ -
Mezzanine Loans (A)	906,907	302,740	904,686	302,816	22	8.61%	2.67	-
Bank Loans	233,793	56,274	233,895	56,563	6	7.75%	3.92	-
Whole Loans	61,240	23,082	61,703	22,364	3	12.63%	1.81	-
ICH Loans (B)	123,390	165,514	121,834	161,288	70	7.77%	1.10	3,530
Total Real Estate Related Loans	$ 1,573,570	$ 619,783	$ 1,568,916	$ 615,551	110	8.48%	2.71	$ 3,530
Residential Loans	$ 168,649	$ 326,100	$ 172,839	$ 333,226	491	6.42%	2.79	$ 4,742
Manufactured Housing Loans	643,912	284,870	636,258	267,456	18,343	8.48%	6.02	8,199
Total Residential Mortgage Loans	$ 812,561	$ 610,970	$ 809,097	$ 600,682	18,834	8.03%	5.35	$ 13,571
Subprime Mortgage loans subject to Future Repurchase (C)	$ 299,176		$ 288,202					

(A) One of these loans has an 8.9 million contractual exit fee which Newcastle will begin to accrue when management believes it is probable that such exit fee will be received. These loans are comprised as follows:

$ 100,000	$ 100,000	$ 100,023	$ 100,052	1	8.58%	1.79
70,000	-	70,000	-	1	8.35%	1.28
87,500	-	87,500	-	1	9.59%	3.36
108,690	-	108,518	-	1	8.30%	1.80
87,664	-	87,689	-	1	7.07%	9.53
453,053	202,740	450,956	202,764	17	8.84%	1.83
$ 906,907	$ 302,740	$ 904,686	$ 302,816	22	8.61%	2.67

(B) In 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 ICH, 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 below.

(D) The aggregate United States federal income tax basis for such assets at December 31, 2006 was approximately equal to their book basis.

(E) The weighted average maturity 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.

(F) 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, 2004	$ (2,473)	$ -
Provision for credit losses	(2,852)	(5,568)
Realized losses	1,099	2,361
Balance at December 31, 2005	$ (4,226)	$ (3,207)
Provision for credit losses	(1,154)	(8,284)
Realized losses	3,230	4,235
Balance at December 31, 2006	$ (2,150)	$ (7,256)

Newcastle has entered into total rate of return swaps with major investment banks 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. 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 December 31, 2006, Newcastle held an aggregate of $299.7 million notional amount of total rate of return swaps on 8 reference assets on which it had deposited $46.8 million of margin. These total rate of return swaps had an aggregate fair value of approximately $1.3 million, a weighted average receive interest rate of LIBOR + 2.59%, a weighted average pay interest rate of LIBOR + 0.63%, and a weighted average swap maturity of 1.5 years.

The average carrying amount of Newcastle's real estate related loans was approximately $995.8 million, $594.1 million and $486.2 million during 2006, 2005 and 2004, respectively, on which Newcastle earned approximately $67.3 million, $54.7 million and $36.7 million of gross revenues, respectively.

The average carrying amount of Newcastle's residential mortgage loans was approximately $783.2 million, $764.2 million and $637.4 million during 2006, 2005 and 2004, respectively, on which Newcastle earned approximately $105.6 million, $48.8 million and $19.1 million of gross revenues, respectively.

The loans are encumbered by various debt obligations as described in Note 8.

Real estate owned ("REO") as a result of foreclosure on loans is included in Receivables and Other Assets, and is recorded at the lower of cost or fair value. No material REO was owned as of December 31, 2006 or 2005.

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 Nationstar Mortgage, LLC (formerly known as 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.

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 December 31, 2006:

Total securitized loans (unpaid principal balance)	$	1,192,763
Loans subject to future repurchase (carrying value)	$	288,202
Retained interests (fair value)	$	79,105
Weighted average life (years) of residual interest		2.52
Expected credit losses		5.1%
Effect on fair value of retained interests of 10% adverse change	$	(3,160)
Effect on fair value of retained interests of 20% adverse change	$	(5,460)
Weighted average constant prepayment rate		31.0%
Effect on fair value of retained interests of 10% adverse change	$	(3,806)
Effect on fair value of retained interests of 20% adverse change	$	(6,435)
Discount rate		18.8%
Effect on fair value of retained interests of 10% adverse change	$	(2,175)
Effect on fair value of retained interests of 20% adverse change	$	(4,272)

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 December 31, 2006 and net credit losses for the period then ended:

Loan unpaid principal balance (UPB)	$	1,192,763
Delinquencies of 60 or more days (UPB)	$	52,281
Net credit losses	$	57

Newcastle received net proceeds of $1.41 billion from the securitization transaction completed in April 2006 and net cash inflows of $27.4 million from the retained interests subsequent to the securitization in 2006.

The weighted average yield of the retained bonds was 11.04% and the weighted average funding cost of the related repurchase agreement was 5.80% as of December 31, 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%.

6. OPERATING REAL ESTATE

The following is a reconciliation of operating real estate assets and accumulated depreciation:

Operating Real Estate	Gross	Accumulated Depreciation	Net
Balance at December 31, 2004	$ 65,691	$ (8,498)	$ 57,193
Improvements	-	-	-
Foreign currency translation	(422)	(28)	(450)
Depreciation	-	(704)	(704)
Transferred to Real Estate Held for Sale	(45,060)	5,694	(39,366)
Balance at December 31, 2005	$ 20,209	$ (3,536)	$ 16,673
Foreclosed loans	12,486	-	12,486
Improvements	1,301	-	1,301
Foreign currency translation	(32)	7	(25)
Fully depreciated assets	(150)	150	-
Depreciation	-	(809)	(809)
Balance at December 31, 2006	$ 33,814	$ (4,188)	$ 29,626

Real Estate Held for Sale	
Balance at December 31, 2004	$ 12,376
Improvements	182
Foreign currency translation	(1,620)
Sold	(50,304)
Transferred from Operating Real Estate	39,366
Balance at December 31, 2005 and 2006	$ -

During the periods presented, Newcastle's operating real estate was comprised of Canadian properties, Belgian properties, foreclosed domestic properties and an investment in an unconsolidated subsidiary which owns domestic properties.

The following is a schedule of the future minimum rental payments to be received under non-cancelable operating leases:

2007	$	3,084
2008		2,300
2009		2,116
2010		1,954
2011		1,751
	$	11,205

In June 2004, Newcastle consummated the sale of five properties in Belgian. These properties had been classified as held for sale since December 2003. Newcastle recognized a $1.5 million loss on this sale in December 2003. In addition, Newcastle recognized a $1.1 million loss in 2004, primarily related to the prepayment of the debt on such properties.

In December 2004, Newcastle sold two properties in the Belgian portfolio at a gain of approximately $5.3 million, net of $2.6 million of prepayment penalties on the related debt.

In March 2005, Newcastle closed on the sale of a property in the Canadian portfolio and recorded a gain of approximately $0.4 million, net of $0.9 million of prepayment penalties on the related debt.

In June 2005, Newcastle closed on the sale of a property in the Canadian portfolio and recorded a gain (net of Canadian taxes) of approximately $0.9 million, net of $2.1 million of prepayment penalties on the related debt.

In June 2005, Newcastle closed on the sale of the last property in the Belgian portfolio and recorded a loss of approximately $0.7 million.

Pursuant to SFAS No. 144, Newcastle has retroactively recorded the operations, including the gain or loss, of all sold or "held for sale" properties in Income from Discontinued Operations for all periods presented.

The following table summarizes the financial information for the discontinued operations:

	Year Ended December 31,		
	2006	2005	2004
Interest and other income	$ 18	$ 4,744	$ 15,301
Net gain on sale	419	780	3,778
Gross revenues	437	5,524	19,079
Interest expense	-	804	5,885
Other expenses	214	2,612	8,748
Net income	$ 223	$ 2,108	$ 4,446

No income tax related to discontinued operations was recorded for the years ended December 31, 2006, 2005 or 2004.

The following table sets forth certain information regarding the operating real estate portfolio:

Type of Property	Location	Net Rentable Sq. Ft. (A)	Acquisition Date	Year Built/ Renovated (A)
Canada Portfolio				
Office Building	London, ON	312,874	Oct 98	1982
Ohio Portfolio				
Office Building	Beavercreek, OH	54,927	Mar 06	1986
Office Building	Beavercreek, OH	29,916	Mar 06	1986
Office Building	Beavercreek, OH	45,299	Mar 06	1986
Retail	Dayton, OH	33,485	Mar 06	1989
Office Building	Vandalia, OH	46,614	Mar 06	1987
Office Building	Dayton, OH	42,286	Mar 06	1985

			December 31, 2006			
Portfolio	Initial Cost (B)	Costs Capitalized Subsequent to Acquisition (B)	Gross Carrying Amount	Accumulated Depreciation	Net Carrying Value (C)	Occupancy (A)
Canada Portfolio	$ 19,758	$ 688	$ 20,446	$ (3,893)	$ 16,553	60.6%
Ohio Portfolio	12,486	882	13,368	(295)	13,073	59.1%

No encumbrances were recorded as of December 31, 2006.

(A) Unaudited.

(B) For the Canada portfolio, adjusted for changes in foreign currency exchange rates, which aggregated $0.0 million of gain and $0.7 million of gain between land, building and improvements in 2006 and 2005, respectively and net of fully depreciated assets of $0.2 million.

(C) The aggregate United States federal income tax basis for such assets at December 31, 2006 was equal to its net carrying value.

7. FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair values for a majority of Newcastle's investments are readily obtainable through broker quotations. For certain of Newcastle's 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. It should be noted that minor changes in assumptions or estimation methodologies can have a material effect on these derived or estimated fair values, and that the fair values reflected below are indicative of the interest rate and credit spread environments as of December 31, 2006 and do not take into consideration the effects of subsequent interest rate or credit spread fluctuations.

The carrying values and estimated fair values of Newcastle's financial instruments at December 31, 2006 and 2005 were as follows:

	Carrying Value		Principal Balance or Notional Amount	Estimated Fair Value	
	December 31,		December 31,	December 31,	
	2006	2005	2006	2006	2005
Assets:					
Real estate securities, available for sale	$ 5,581,228	$ 4,554,519	$ 5,604,249	$ 5,581,228	$ 4,554,519
Real estate related loans	1,568,916	615,551	1,573,570	1,571,412	615,865
Residential mortgage loans	809,097	600,682	812,561	829,980	609,486
Subprime mortgage loans subject to future repurchase	288,202	-	299,176	288,202	-
Interest rate caps, treated as hedges (A)	1,262	2,145	334,971	1,262	2,145
Total return swaps (A)	1,288	3,096	299,654	1,288	3,096
Liabilities:					
CBO bonds payable	4,313,824	3,530,384	4,340,166	4,369,540	3,594,638
Other bonds payable	675,844	353,330	679,891	676,512	356,294
Notes payable	128,866	260,441	128,866	128,866	260,441
Repurchase agreements	760,346	1,048,203	760,346	760,346	1,048,203
Repurchase agreements subject to ABCP	1,143,749	-	1,143,749	1,143,749	-
Financing of subprime mortgage loans subject to future repurchase	288,202	-	299,176	288,202	-
Credit facility	93,800	20,000	93,800	93,800	20,000
Junior subordinated notes payable	100,100	-	100,100	101,629	-
Interest rate swaps, treated as hedges (B)	(42,887)	(41,170)	3,943,120	(42,887)	(41,170)
Non-hedge derivative obligations (C)	360	90	See below	360	90

(A) Included in Derivative Assets. The longest cap maturity is October 2015. The longest total rate of return swap maturity is December 2008.
(B) Included in Derivative Assets or Liabilities, as applicable. A positive number represents a liabilty. The longest swap maturity is June 2016.
(C) Included in Derivative Assets or Liabilities, as applicable. A positive number represents a liabilty. The longest maturity is July 2038.

The methodologies used and key assumptions made to estimate fair value are as follows:

Real Estate Securities, Available for Sale ¾ The fair value of these securities is estimated by obtaining third party broker quotations, if available and practicable, and counterparty quotations.

Real Estate Related Loans ¾ 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.

Residential Mortgage Loans ¾ This aggregate portfolio of residential loans consists of a portfolio of floating rate residential mortgage loans as well as two portfolios of substantially fixed rate manufactured housing loans. These loans were valued by reference to current market interest rates and credit spreads.

Subprime Mortgage Loans Subject to Future Repurchase and related Financing—These two items, related to the securitization of subprime mortgage loans, are equal and offsetting. They are further described in Note 5.

Interest Rate Cap and Swap Agreements, Total Rate of Return Swaps and Non-Hedge Derivative Obligations ¾ The fair value of these agreements is estimated by obtaining counterparty quotations. The total rate of return swaps are more fully described in Note 5.

CBO Bonds Payable ¾ 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.

Other Bonds Payable ¾ The ICH 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 were valued by reference to current market interest rates and credit spreads.

Notes Payable ¾ The residential mortgage loan financing was valued by reference to current market interest rates and credit spreads.

Repurchase Agreements ¾ These agreements bear floating rates of interest, which reset monthly or quarterly to a market credit spread, and Newcastle believes 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.

Credit facility ¾ This facility was valued at par because management believes it could currently enter into a similar arrangement under similar terms.

Junior Subordinated Notes Payable— These notes were values 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.

8. DEBT OBLIGATIONS

The following table presents certain information regarding Newcastle's debt obligations and related hedges:

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
		December 31,		December 31,		December 31, 2006								
CBO Bonds \Payable		2006	2005	2006	2005									
Real estate securities	Jul 1999	$ 398,366	$ 426,653	$ 395,646	$ 423,191	6.94% (2)	Jul 2038	5.50%	1.99	$ 303,366	$ 544,469	4.06	$ -	$ 255,352
Real estate securities and loans	Apr 2002	444,000	444,000	441,660	441,054	6.42% (2)	Apr 2037	6.78%	3.45	372,000	498,754	5.15	59,612	296,000
Real estate securities and loans	Mar 2003	472,000	472,000	468,944	468,413	6.23% (2)	Mar 2038	5.35%	5.30	427,800	515,335	4.56	128,600	285,060
Real estate securities and loans	Sep 2003	460,000	460,000	456,250	455,657	6.08% (2)	Sep 2038	5.88%	5.85	442,500	505,450	4.28	151,677	207,500
Real estate securities and loans	Mar 2004	414,000	414,000	411,014	410,511	5.93% (2)	Mar 2039	5.38%	5.61	382,750	446,749	4.76	174,192	177,300
Real estate securities and loans	Sep 2004	454,500	454,500	451,137	450,639	5.91% (2)	Sep 2039	5.49%	6.19	442,500	499,389	5.08	227,898	209,202
Real estate securities and loans	Apr 2005	447,000	447,000	442,870	442,379	5.81% (2)	Apr 2040	5.53%	7.16	439,600	491,398	5.82	195,186	242,990
Real estate securities	Dec 2005	442,800	442,800	438,894	438,540	5.85% (2)	Dec 2050	5.57%	8.48	436,800	512,249	7.23	115,491	341,506
Real estate securities and loans	Nov 2006	807,500	-	807,409	-	5.98% (2)	Nov 2052	5.92%	7.06	799,900	930,293	4.69	672,217	153,655
		4,340,166	3,560,953	4,313,824	3,530,384			5.73%	5.83	4,047,216	4,944,086	5.05	1,724,873	2,168,565
Other Bonds Payable														
ICH loans (3)	(3)	101,925	141,311	101,925	141,311	6.78% (2)	Aug 2030	6.78%	1.04	1,986	121,834	1.10	1,986	-
Manufactured housing loans	Jan 2006	213,172	212,019	211,738	212,019	LIBOR +1.25%	Jan 2009	6.14%	1.46	213,172	237,133	6.26	4,977	204,617
Manufactured housing loans	Aug 2006	364,794	-	362,181	-	LIBOR +1.25%	Aug 2011	6.87%	3.07	364,794	399,125	5.87	73,973	370,466
		679,891	353,330	675,844	353,330			6.63%	2.26	579,952	758,092	5.23	80,936	575,083
Notes Payable														
Residential mortgage loans (4)	Nov 2004	128,866	260,441	128,866	260,441	LIBOR+0.16%	Nov 2007	5.68%	0.74	128,866	145,819	2.79	142,301	-
Repurchase Agreements (4) (8)														
Real estate securities	Rolling	181,059	149,546	181,059	149,546	LIBOR + 0.41%	Jan 2007	5.62%	0.08	181,059	207,374	4.60	101,380	92,457
Real estate related loans	Rolling	553,944	185,278	553,944	185,278	LIBOR + 0.69%	Jan 2007	6.02%	0.08	553,944	718,989	2.21	696,174	19,630
Residential mortgage loans	Rolling	25,343	41,853	25,343	41,853	LIBOR + 0.43%	Mar 2007	5.79%	0.23	25,343	27,020	2.81	26,347	-
		760,346	376,677	760,346	376,677			5.92%	0.08	760,346	953,383	2.77	823,901	112,087
Repurchase agreements subject to ABCP facility (7)														
Agency RMBS	Dec 2006	1,143,749	671,526	1,143,749	671,526	5.41%	Jan 2007	4.97%	0.08	1,143,749	1,176,358	4.27	-	1,087,385
Credit facility (5)	May 2006	93,800	20,000	93,800	20,000	LIBOR + 1.75%	Nov 2007	7.08%	0.85	93,800	-	-	-	-
Junior subordinated notes payable	Mar 2006	100,100	-	100,100	-	7.80% (6)	Apr 2036	7.72%	29.25	-	-	-	-	-
Subtotal debt obligations		7,246,918	5,242,927	7,216,529	5,212,358			5.76%	4.15	$ 6,753,929	$ 7,977,738	4.63	$ 2,772,011	$ 3,943,120
Financing on subprime mortgage loans subject to future repurchase (3)	Apr 2006	299,176	-	288,202	-									
Total debt obligations		$ 7,546,094	$ 5,242,927	$ 7,504,731	$ 5,212,358									

(1) Including the effect of applicable hedges.
(2) Weighted average, including floating and fixed rate classes.
(3) See Note 5.
(4) Subject to potential mandatory prepayments based on collateral value.
(5) A maximum of $200 million can be drawn.
(6) LIBOR + 2.25% after April 2016.
(7) ABCP means asset backed commercial paper. See below.
(8) The counterparties on our repurchase agreements include: Bear Stearns Mortgage Capital Corporation ($270.6 million), Credit Suisse ($216.2 million), Deutsche Bank AG ($181.7 million) and other ($91.8 million).

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

CBO Bonds Payable

In connection with the sale of two classes of CBO bonds in our first CBO, Newcastle entered into two interest rate swaps and three interest rate cap agreements that do not qualify for hedge accounting.

Two classes of separately issued 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.

Junior Subordinated Notes Payable

In March 2006, Newcastle completed the placement of $100 million of trust preferred securities through its wholly owned subsidiary, Newcastle Trust I (the “Preferred Trust”). Newcastle 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 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 (Note 3).

Credit Facility

In May 2006, Newcastle entered into a new 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 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.

Repurchase Agreements Subject to ABCP Facility

In December 2006, Newcastle closed a $2 billion asset backed commercial paper (ABCP) facility through its wholly owned subsidiary, Windsor Funding Trust. This facility provides Newcastle with the ability to finance its agency residential mortgage backed securities (RMBS) and AAA-rated MBS by issuing secured liquidity notes that are rated A-1+, P-1 and F-1+, by Standard & Poor’s, Moody’s and Fitch respectively, and have maturities of up to 250 days. The facility also permits the issuance of subordinated notes rated at least BBB/Baa by Standard & Poor’s, Moody’s or Fitch. As of December 31, 2006, Windsor Trust Funding had approximately $1.1 billion of secured liquidity notes and $8.3 million of subordinated notes issued and outstanding. The weighted average maturities of the secured liquidity notes and the subordinated notes were 0.12 years and 5 years, respectively. Newcastle owns all of the trust certificates of the Windsor Funding Trust. Windsor Funding Trust used the proceeds of the issuance to enter into a repurchase agreement with Newcastle to purchase interests in Newcastle’s agency RMBS. The repurchase agreements represent Windsor Funding Trust’s only asset. The interest rate on the repurchase agreement is effectively the weighted average interest rate on the secured liquidity notes and subordinated notes. Under the provisions of FIN 46R, Newcastle determined that the noteholders were the primary beneficiaries of the Windsor Funding Trust. As a result, Newcastle did not consolidate the Windsor Funding Trust and has reflected its obligation pursuant to the asset backed commercial paper facility under the caption Repurchase Agreements subject to ABCP Facility.

Maturity Table

Newcastle's debt obligations (gross of $41.4 million of discounts at December 31, 2006) have contractual maturities as follows:

2007	$	2,126,761
2008		-
2009		213,172
2010		-
2011		364,794
Thereafter		4,841,367
	$	7,546,094

9. STOCK OPTION PLAN AND 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 stock options. During 2006, 2005 and 2004, based on the treasury stock method, Newcastle had 148,538, 314,125 and 614,038 dilutive common stock equivalents, respectively, resulting from its outstanding options. Net income available for common stockholders is equal to net income less preferred dividends.

In June 2002, Newcastle (with the approval of the board of directors) adopted a nonqualified stock option and incentive award plan (the "Newcastle Option Plan") for officers, directors, consultants and advisors, including the Manager and its employees. The maximum available for issuance is equal to 10% of the number of outstanding equity interests of Newcastle, subject to a maximum of 10,000,000 shares in the aggregate over the term of the plan.

Upon joining the board, the non-employee directors have been, in accordance with the Newcastle Option Plan, automatically granted options to acquire an aggregate of 18,000 shares of common stock. The fair value of such options was not material at the date of grant.

Through December 31, 2006, for the purpose of compensating the Manager for its successful efforts in raising capital for Newcastle, the Manager has been granted options representing the right to acquire 2,825,727 shares of common stock, with strike prices subject to adjustment as necessary to preserve the value of such options in connection with the occurrence of certain events (including capital dividends and capital distributions made by Newcastle). The Manager options represented an amount equal to 10% of the shares of common stock of Newcastle sold in its public offerings and the value of such options was recorded as an increase in stockholders’ equity with an offsetting reduction of capital proceeds received. The options granted to the Manager, which may be assigned by the Manager to its employees, were fully vested on the date of grant and one thirtieth of the options become exercisable on the first day of each of the following thirty calendar months, or earlier upon the occurrence of certain events, such as a change in control of Newcastle or the termination of the Management Agreement. The options expire ten years from the date of issuance.

The following table summarizes our outstanding options at December 31, 2006. Note that the last sales price on the New York Stock Exchange for our common stock in the year ended December 31, 2006 was $31.32.

Recipient	Date of Grant/Exercise	Number of Options	Weighted Average Exercise Price	Fair Value At Grant Date (Millions)
Directors	Various	18,000	$17.38	Not Material
Manager (B)	October 2002	700,000	$13.00	$0.4 (A)
Manager (B)	July 2003	460,000	$20.35	$0.8 (A)
Manager (B)	December 2003	328,227	$22.85	$0.4 (A)
Manager (B)	January 2004	330,000	$26.30	$0.6 (A)
Manager (B)	May 2004	345,000	$25.75	$0.5 (A)
Manager (B)	November 2004	162,500	$31.40	$0.5 (A)
Manager (B)	January 2005	330,000	$29.60	$1.1 (A)
Manager (B)	November 2006	170,000	$29.42	$0.5 (A)
Excercised (B)	Prior to 2006	(861,920)	$15.27	
Excercised (B)	2006	(98,000)	$18.06	
Outstanding		1,883,807	$25.89	

(A) The fair value of the options was estimated using a binomial option pricing model. Since the Newcastle Option Plan has characteristics significantly different from those of traded options, and since the assumptions used in such model, particularly the volatility assumption, are subject to significant judgment and variability, the actual value of the options could vary materially from management's estimate. The assumptions used in such model were as follows:

Date of Grant	Volatility	Dividend Yield	Expected Life (Years)	Risk-Free Rate
October 2002	15%	13.85%	10	4.05%
July 2003	15%	9.83%	10	3.63%
December 2003	15%	8.75%	10	4.23%
January 2004	15%	7.60%	10	4.23%
May 2004	15%	9.32%	10	4.77%
November 2004	18%	7.64%	10	4.21%
January 2005	21%	8.45%	10	4.27%
November 2006	21%	8.84%	5	4.69%

The volatility assumption for options issued in 2005 and 2006 was estimated based primarily on the historical volatility of Newcastle's common stock and management's expectations regarding future volatility. The expected life assumption for options issued subsequent to January 2005 was estimated based on the simplified term method.

(B) The Manager assigned certain of its options to its employees as follows:

Strike Price	Total Inception to Date
$13.00	269,500
$20.35	193,200
$22.85	139,355
$26.30	127,050
$31.40	62,563
$29.42	85,425
Total	877,093

670,620 of the total options exercised were by the Manager. 285,300 of the total options exercised were by employees of the Manager subsequent to their assignment. 4,000 of the total options exercised were by directors.

10. MANAGEMENT AGREEMENT AND RELATED PARTY TRANSACTIONS

Manager

Newcastle entered into the Management Agreement with the Manager in June 2002, as amended, which provided for an initial term of one year with automatic one year extensions, subject to certain termination rights. After the initial one year term, the Manager's performance is reviewed annually and the Management Agreement may be terminated by Newcastle by payment of a termination fee, as defined in the Management Agreement, equal to the amount of management fees earned by the Manager during the twelve consecutive calendar months immediately preceding the termination, upon the affirmative vote of at least two-thirds of the independent directors, or by a majority vote of the holders of common stock. Pursuant to the Management Agreement, the Manager, under the supervision of Newcastle's board of directors, formulates investment strategies, arranges for the acquisition of assets, arranges for financing, monitors the performance of Newcastle's assets and provides certain advisory, administrative and managerial services in connection with the operations of Newcastle. For performing these services, Newcastle pays the Manager an annual management fee equal to 1.5% of the gross equity of Newcastle, as defined.

The Management Agreement provides that Newcastle will reimburse the Manager for various expenses incurred by the Manager or its officers, employees and agents on Newcastle's behalf, including costs of legal, accounting, tax, auditing, administrative and other similar services rendered for Newcastle by providers retained by the Manager or, if provided by the Manager's employees, in amounts which are no greater than those which would be payable to outside professionals or consultants engaged to perform such services pursuant to agreements negotiated on an arm's-length basis.

To provide an incentive for the Manager to enhance the value of the common stock, the Manager is entitled to receive an incentive return (the "Incentive Compensation") on a cumulative, but not compounding, basis in an amount equal to the product of (A) 25% of the dollar amount by which (1) (a) the Funds from Operations, as defined (before the Incentive Compensation) of Newcastle per share of common stock (based on the weighted average number of shares of common stock outstanding) plus (b) gains (or losses) from debt restructuring and from sales of property and other assets per share of common stock (based on the weighted average number of shares of common stock outstanding), exceed (2) an amount equal to (a) the weighted average of the price per share of common stock in the IPO and the value attributed to the net assets transferred to us by our predecessor, and in any subsequent offerings by Newcastle (adjusted for prior capital dividends or capital distributions) multiplied by (b) a simple interest rate of 10% per annum (divided by four to adjust for quarterly calculations) multiplied by (B) the weighted average number of shares of common stock outstanding.

	Amounts Incurred (in millions)		
	2006	**2005**	**2004**
Management Fee	$13.5	$12.8	$10.1
Expense Reimbursement	0.5	0.5	0.5
Incentive Compensation	12.2	7.6	8.0

At December 31, 2006, the Manager, through its affiliates, and principals of Fortress, owned 2.9 million shares of Newcastle's common stock and the manager through its affiliates, had options to purchase an additional 1.3 million shares of Newcastle's common stock (Note 9).

At December 31, 2006, Due To Affiliates is comprised of $12.2 million of incentive compensation payable and $1.3 million of management fees and expense reimbursements payable to the Manager.

Other Affiliates

In November 2003, Newcastle and a private investment fund managed by an affiliate of our manager co-invested and each indirectly own an approximately 38% interest in a limited liability company (Note 3) that has acquired a pool of franchise loans from a third party financial institution. Newcastle's investment in this entity, reflected as an investment in an unconsolidated subsidiary on Newcastle's consolidated balance sheet, was approximately $10.2 million at December 31, 2006. The remaining approximately 24% interest in the limited liability company is owned by the above-referenced third party financial institution.

As of December 31, 2006, Newcastle owned an aggregate of approximately $108.0 million of securities of Global Trust II and III, special purpose vehicles established by Global Signal Inc., which were purchased in private placements from underwriters in January 2004, April 2005 and February 2006. Newcastle's CEO and chairman of its board of directors was the chairman of the board of Global Signal, Inc. and private equity funds managed by an affiliate of Newcastle's manager own a significant portion of Global Signal Inc.'s common stock. In January 2007, Global Signal was acquired by Crown Castle International Corp. Newcastle's affiliate no longer had significant influence over Global Signal subsequent to the acquisition.

In March 2004, Newcastle and a private investment fund managed by an affiliate of Newcastle's manager co-invested and each indirectly own an approximately 49% interest in two limited liability companies (Note 3) that have acquired, in a sale-leaseback transaction, a portfolio of convenience and retail gas stores from a public company. The properties are subject to a number of master leases, the initial term of which in each case is a minimum of 15 years. This investment was financed with nonrecourse debt at the limited liability company level and Newcastle's investment in this entity, reflected as an investment in an unconsolidated subsidiary on Newcastle's consolidated balance sheet, was approximately $12.5 million at December 31, 2006. In March 2005, the property management agreement related to these properties was transferred to an affiliate of Newcastle's manager from a third party servicer; Newcastle's allocable portion of the related fees, approximately $20,000 per year for three years, was not changed.

In January 2005, Newcastle entered into a servicing agreement with a portfolio company of a private equity fund advised by an affiliate of Newcastle's manager for them to service a portfolio of manufactured housing loans (Note 5), 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, Newcastle closed on a new term financing of this portfolio. In connection with this term financing, Newcastle renewed its servicing agreement at the same terms. The outstanding unpaid principal balance of this portfolio was approximately $245.7 million at December 31, 2006.

In April 2006, Newcastle securitized its 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 Newcastle's 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 $1.2 billion at December 31, 2006.

In August 2006, Newcastle acquired a portfolio of manufactured housing loans. The loans are being serviced by a portfolio company of a private equity fund advised by an affiliate of Newcastle's 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 $398.3 million at December 31, 2006.

In September 2006, Newcastle was a co-lender with two private investment funds managed by an affiliate of Newcastle's manager in a new real estate related loan. The loan is secured by a first mortgage interest on a parcel of land in Arizona. Newcastle owns 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, Newcastle 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 Newcastle owning a 20% interest in the junior participation interest in the loan. Newcastle's investment in this loan was approximately $26.1 million at December 31, 2006.

As of December 31, 2006, Newcastle held total investments of $192.2 million face amount of real estate securities and real estate related loans issued by affiliates of its manager and earned approximately $18.5 million, $13.7 million and $13.1 million of interest on investments issued by affiliates for the years ended December 31, 2006, 2005 and 2004, respectively.

In each instance described above, affiliates of Newcastle's manager have an investment in the applicable affiliated fund and receive from the fund, in addition to management fees, incentive compensation if the fund's aggregate investment returns exceed certain thresholds.

11. COMMITMENTS AND CONTINGENCIES

Remarketing Agreements ¾ Two classes of separately issued CBO bonds (Note 8), 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, pursuant to a financial guaranty insurance policy ("wrap"). Newcastle pays annual fees of 0.12% of the outstanding face amount of such bonds under this agreement.

In connection with the remarketing procedures described above, backstop agreements have been created whereby a third party financial institution is required to purchase the $718.0 million face amount of bonds at the end of any remarketing period if such bonds could not be resold in the market by the remarketing agent. Newcastle pays an annual fee of between 0.15% and 0.20% of the outstanding face amount of such bonds under these agreements.

In addition, the remarketing agent is paid an annual fee of 0.05% of the outstanding face amount of such bonds under the remarketing agreements.

Loan Commitment— With respect to one of its real estate related loans, Newcastle was committed to fund up to an additional $6.6 million at December 31, 2006, subject to certain conditions to be met by the borrower.

Stockholder Rights Agreement ¾ Newcastle has adopted a stockholder rights agreement (the "Rights Agreement"). Pursuant to the terms of the Rights Agreement, Newcastle will attach to each share of common stock one preferred stock purchase right (a "Right"). Each Right entitles the registered holder to purchase from Newcastle a unit consisting of one one-hundredth of a share of Series A Junior Participation Preferred Stock, par value $0.01 per share, at a purchase price of $70 per unit. Initially, the Rights are not exercisable and are attached to and transfer and trade with the outstanding shares of common stock. The Rights will separate from the common stock and will become exercisable upon the acquisition or tender offer to acquire a 15% beneficial ownership interest by an acquiring person, as defined. The effect of the Rights Agreement will be to dilute the acquiring party's beneficial interest. Until a Right is exercised, the holder thereof, as such, will have no rights as a stockholder of Newcastle.

Litigation ¾ Newcastle is, from time to time, a defendant in legal actions from transactions conducted in the ordinary course of business. Management, after consultation with legal counsel, believes the ultimate liability arising from such actions which existed at December 31, 2006, if any, will not materially affect Newcastle's consolidated results of operations or financial position.

Environmental Costs ¾ As a commercial real estate owner, Newcastle is subject to potential environmental costs. At December 31, 2006, management of Newcastle is not aware of any environmental concerns that would have a material adverse effect on Newcastle's consolidated financial position or results of operations.

Debt Covenants ¾ Newcastle's debt obligations contain various customary loan covenants. Such covenants do not, in management's opinion, materially restrict Newcastle's investment strategy or ability to raise capital at this time. Newcastle is in compliance with all of its loan covenants at December 31, 2006.

Exit Fee ¾ One of Newcastle's loan investments provides for an $8.9 million contractual exit fee which Newcastle will begin to accrue for if and when management believes it is probable that such exit fee will be received.

12. INCOME TAXES AND DIVIDENDS

Newcastle Investment Corp. is organized and conducts its operations to qualify as a REIT under the Code. A REIT will generally not be subject to U.S. federal corporate income tax on that portion of its net income that is distributed to stockholders if it distributes at least 90% of its REIT taxable income to its stockholders by prescribed dates and complies with various other requirements.

Since Newcastle distributed 100% of its 2006, 2005 and 2004 REIT taxable income, no provision has been made for U.S. federal corporate income taxes in the accompanying consolidated financial statements, except in connection with Newcastle's taxable REIT subsidiary ("TRS").

Distributions relating to 2006, 2005, and 2004 were taxable as follows:

	Dividends Per Share (A)		Ordinary/	Capital	
	Book Basis	Tax Basis	Qualified Income	Gains	Return of Capital
2006	$2.615	$2.948	100.00%	-	None
2005	$2.500	$2.540	86.41%	13.59%	None
2004	$2.425	$2.432	76.60%	23.40%	None

(A) Any excess of book basis dividends over tax basis dividends would generally be carried forward to the next year for tax purposes.

Dividends in Excess of Earnings includes ($14.5 million) related to the operations of our predecessor.

Newcastle has elected to treat NC Circle Holdings II LLC as a taxable REIT subsidiary ("TRS"), effective February 27, 2004. NC Circle Holdings II LLC owned a portion of Newcastle's investment in a portfolio of convenience and retail gas stores as described in Note 3. For taxable income generated by NC Circle Holdings II LLC, Newcastle has provided for relevant income taxes based on a blended statutory rate of 40%. Newcastle accounts for income taxes using the asset and liability method under which deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. No such material differences have been recognized through December 31, 2006.

13. SUBSEQUENT EVENTS

In January 2007, Newcastle issued 2.42 million shares of its common stock in a public offering at a price to the public of $31.30 per share for net proceeds of approximately $75.0 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 242,000 shares of Newcastle's common stock at the public offering price, which were valued at approximately $0.8 million.

In January 2007, certain of the Manager's employees exercised options to acquire 3,282 shares of Newcastle's common stock for net proceeds of $0.1 million.

In January 2007, Newcastle entered into an $700 million non-recourse 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%.

14. SUMMARY QUARTERLY CONSOLIDATED FINANCIAL INFORMATION (UNAUDITED)

The following is unaudited summary information on Newcastle's quarterly operations.

2006	**Quarter Ended**				Year Ended
	March 31 (A)	June 30 (A)	September 30 (A)	December 31	December 31
Gross Revenues	$ 123,548	$ 129,027	$ 144,094	$ 155,940	$ 552,609
Operating expenses	(16,911)	(10,999)	(13,032)	(14,581)	(55,523)
Operating income	106,637	118,028	131,062	141,359	497,086
Interest expense	(76,965)	(87,909)	(100,239)	(109,156)	(374,269)
Depreciation and amortization	(199)	(278)	(290)	(318)	(1,085)
Equity in earnings of unconsolidated subsidiaries (B)	1,195	1,215	1,506	2,052	5,968
Income from continuing operations	30,668	31,056	32,039	33,937	127,700
Income (loss) from discontinued operations	251	(26)	(12)	10	223
Preferred dividends	(2,328)	(2,329)	(2,328)	(2,329)	(9,314)
Income available for common stockholders	$ 28,591	$ 28,701	$ 29,699	$ 31,618	$ 118,609
Net Income per share of common stock					
Basic	$ 0.65	$ 0.65	$ 0.68	$ 0.70	$ 2.68
Diluted	$ 0.65	$ 0.65	$ 0.67	$ 0.70	$ 2.67
Income from continuing operations per share of common stock, after preferred dividends and related accretion					
Basic	$ 0.64	$ 0.65	$ 0.68	$ 0.70	$ 2.67
Diluted	$ 0.64	$ 0.65	$ 0.67	$ 0.70	$ 2.67
Income (loss) from discontinued operations per share of common stock					
Basic	$ 0.01	$ 0.00	$ 0.00	$ 0.00	$ 0.01
Diluted	$ 0.01	$ 0.00	$ 0.00	$ 0.00	$ 0.00
Weighted average number of shares of common stock outstanding					
Basic	43,945	43,991	44,000	45,129	44,269
Diluted	44,064	44,071	44,137	45,385	44,417

2005	**Quarter Ended**				Year Ended
	March 31 (A)	June 30 (A)	September 30 (A)	December 31	December 31
Gross Revenues	$ 83,663	$ 92,065	$ 99,850	$ 102,635	$ 378,213
Operating expenses	(9,114)	(8,832)	(12,934)	(11,008)	(41,888)
Operating income	74,549	83,233	86,916	91,627	336,325
Interest expense	(48,766)	(55,791)	(58,681)	(63,208)	(226,446)
Depreciation and amortization	(136)	(135)	(182)	(188)	(641)
Equity in earnings of unconsolidated subsidiaries (B)	1,853	1,393	1,061	1,302	5,609
Income from continuing operations	27,500	28,700	29,114	29,533	114,847
Income (loss) from discontinued operations	1,184	781	86	57	2,108
Preferred dividends	(1,523)	(1,524)	(1,523)	(2,114)	(6,684)
Income available for common stockholders	$ 27,161	$ 27,957	$ 27,677	$ 27,476	$ 110,271
Net Income per share of common stock					
Basic	$ 0.63	$ 0.64	$ 0.63	$ 0.63	$ 2.53
Diluted	$ 0.62	$ 0.63	$ 0.63	$ 0.63	$ 2.51
Income from continuing operations per share of common stock, after preferred dividends and related accretion					
Basic	$ 0.60	$ 0.62	$ 0.63	$ 0.63	$ 2.48
Diluted	$ 0.59	$ 0.61	$ 0.63	$ 0.63	$ 2.46
Income (loss) from discontinued operations per share of common stock					
Basic	$ 0.03	$ 0.02	$ 0.00	$ 0.00	$ 0.05
Diluted	$ 0.03	$ 0.02	$ 0.00	$ 0.00	$ 0.05

Weighted average number of shares of common stock outstanding					
Basic	43,222	43,768	43,790	43,897	43,672
Diluted	43,629	44,127	44,121	44,059	43,986

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2006, 2005 and 2004
(dollars in tables in thousands, except per share data)

2004	**Quarter Ended**				Year Ended
	March 31 (A)	June 30 (A)	September 30 (A)	December 31	December 31
Gross Revenues	$ 55,309	$ 61,612	$ 63,146	$ 69,602	$ 249,669
Operating expenses	(7,333)	(6,354)	(7,822)	(7,299)	(28,808)
Operating income	47,976	55,258	55,324	62,303	220,861
Interest expense	(28,091)	(32,615)	(33,612)	(42,080)	(136,398)
Depreciation and amortization	(113)	(95)	(108)	(135)	(451)
Equity in earnings of unconsolidated subsidiaries (B)	1,223	2,218	3,179	3,337	9,957
Income from continuing operations	20,995	24,766	24,783	23,425	93,969
Income (loss) from discontinued operations	856	(1,591)	185	4,996	4,446
Preferred dividends	(1,523)	(1,524)	(1,523)	(1,524)	(6,094)
Income available for common stockholders	$ 20,328	$ 21,651	$ 23,445	$ 26,897	$ 92,321
Net Income per share of common stock					
Basic	$ 0.59	$ 0.60	$ 0.61	$ 0.70	$ 2.50
Diluted	$ 0.58	$ 0.59	$ 0.60	$ 0.69	$ 2.46
Income from continuing operations per share of common stock, after preferred dividends and related accretion					
Basic	$ 0.57	$ 0.64	$ 0.61	$ 0.56	$ 2.38
Diluted	$ 0.56	$ 0.63	$ 0.60	$ 0.55	$ 2.34
Income (loss) from discontinued operations per share of common stock					
Basic	$ 0.02	$ (0.04)	$ 0.00	$ 0.14	$ 0.12
Diluted	$ 0.02	$ (0.04)	$ 0.00	$ 0.14	$ 0.12
Weighted average number of shares of common stock outstanding					
Basic	34,402	36,161	38,234	38,941	36,944
Diluted	34,976	36,671	38,883	39,663	37,558

(A) The Income Available for Common Stockholders shown agrees with Newcastle's quarterly report(s) on Form 10-Q as filed with the Securities and Exchange Commission. However, individual line items may vary from such report(s) due to the operations of properties sold, or classified as held for sale, during subsequent periods being retroactively reclassified to Income for Discontinued Operations for all periods presented (Note 5).

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

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

None.

Item 9A. Controls and Procedures.

(a) Disclosure Controls and Procedures. The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d -15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this report. The Company's disclosure controls and procedures are designed to provide reasonable assurance that information is recorded, processed, summarized and reported accurately and on a timely basis. Based on such evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, the Company's disclosure controls and procedures are effective.

(b) Internal Control Over Financial Reporting. There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Acts) during the most recent fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Management's Report on Internal Control Over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rule 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended, as a process designed by, or under the supervision of, the Company's principal executive and principal financial officers and effected by the Company's board of directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States and includes those policies and procedures that:

- pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company;

- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and

- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

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

Management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2006. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control-Integrated Framework*.

Based on our assessment, management concluded that, as of December 31, 2006, the Company's internal control over financial reporting is designed and operating effectively.

The Company's independent registered public accounting firm has issued an audit report on our assessment of the Company's internal control over financial reporting. This report appears at the beginning of "Financial Statements and Supplementary Data."

By: /s/ Wesley R. Edens
Wesley R. Edens
Chairman of the Board

By: /s/ Debra A. Hess
Debra A. Hess
Chief Financial Officer

Item 9B. Other Information.

None.

PART III

Item 10. Directors, Executive Officers AND Corporate Governance.

Incorporated by reference to our definitive proxy statement for the 2007 annual meeting of stockholders to be filed with the Securities and Exchange Commission pursuant to Regulation 14A of the Securities Exchange Act of 1934, as amended, within 120 days after the fiscal year ended December 31, 2006.

Item 11. Executive Compensation.

Incorporated by reference to our definitive proxy statement for the 2007 annual meeting of stockholders to be filed with the Securities and Exchange Commission pursuant to Regulation 14A of the Securities Exchange Act of 1934, as amended, within 120 days after the fiscal year ended December 31, 2006.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

Incorporated by reference to our definitive proxy statement for the 2007 annual meeting of stockholders to be filed with the Securities and Exchange Commission pursuant to Regulation 14A of the Securities Exchange Act of 1934, as amended, within 120 days after the fiscal year ended December 31, 2006.

Item 13. Certain Relationships and Related Transactions, Director Independence.

Incorporated by reference to our definitive proxy statement for the 2007 annual meeting of stockholders to be filed with the Securities and Exchange Commission pursuant to Regulation 14A of the Securities Exchange Act of 1934, as amended, within 120 days after the fiscal year ended December 31, 2006.

Item 14. Principal Accountant Fees and Services.

Incorporated by reference to our definitive proxy statement for the 2007 annual meeting of stockholders to be filed with the Securities and Exchange Commission pursuant to Regulation 14A of the Securities Exchange Act of 1934, as amended, within 120 days after the fiscal year ended December 31, 2006.

PART IV

Item 15. Exhibits; Financial Statement Schedules.

(a) and (c) Financial statements and schedules:
See "Financial Statements and Supplementary Data."

(b) Exhibits filed with this Form 10-K:

3.1 Articles of Amendment and Restatement (incorporated by reference to the Registrant's Registration Statement on Form S-11 (File No. 333-90578), Exhibit 3.1).

3.2 Articles Supplementary relating to the Series B Preferred Stock (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the period ended March 31, 2003, Exhibit 3.3).

3.3 Articles Supplementary relating to the Series C Preferred Stock (incorporated by reference to the Registrant's Report on Form 8-K, Exhibit 3.3, filed on October 25, 2005).

3.4 By-laws (incorporated by reference to the Registrant's Registration Statement on Form S-11, (File No. 333-90578), Exhibit 3.2).

4.1 Rights Agreement between the Registrant and American Stock Transfer and Trust Company, as Rights Agent, dated October 16, 2002 (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the period ended September 30, 2003, Exhibit 4.1).

10.1 Amended and Restated Management and Advisory Agreement by and among the Registrant and FIG LLC (formerly known as Fortress Investment Group LLC), dated June 23 2003 (incorporated by reference to the Registrant's Statement on Form S-11 (File No. 333-106135), Exhibit 10.1).

10.2 Newcastle Investment Corp. Nonqualified Stock Option and Incentive Award Plan Amended and Restated Effective as of February 11, 2004 (incorporated by reference to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2005, Exhibit 10.2).

12.1 Statements re: Computation of Ratios

21.1 Subsidiaries of the Registrant.

23.1 Consent of Ernst & Young LLP, independent accountants.

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 Section 13 or 15 (d) of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized:

NEWCASTLE INVESTMENT CORP.

February 26, 2007

By: /s/ Wesley R. Edens
Wesley R. Edens
Chairman of the Board

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this report has been signed below by the following person on behalf of the Registrant and in the capacities and on the dates indicated.

February 26, 2007

By: /s/ Kenneth M. Riis
Kenneth M. Riis
Chief Executive Officer

February 26, 2007

By: /s/ Debra A. Hess
Debra A. Hess
Chief Financial Officer

February 26, 2007

By: /s/ Kevin J. Finnerty
Kevin J. Finnerty
Director

February 26, 2007

By: /s/ Stuart A. McFarland
Stuart A. McFarland
Director

February 26, 2007

By: /s/ David K. McKown
David K. McKown
Director

February 26, 2007

By: /s/ Peter M. Miller
Peter M. Miller
Director

Exhibit Index

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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 Current Report 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).
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Exhibit 12.1

RATIO OF EARNINGS TO COMBINED FIXED CHARGES AND PREFERRED DIVIDENDS AND RATIO OF EARNINGS TO FIXED CHARGES

The following table sets forth our ratio of earnings to combined fixed charges and preferred dividends and our ratio of earnings to fixed charges for each of the periods indicated:

	Year Ended December 31,				
	2006	2005	2004	2003	2002 (A)
Ratio of Earnings to Combined Fixed Charges and Preferred Stock Dividends	1.31	1.46	1.62	1.62	1.67
Ratio of Earnings to Fixed Charges	1.34	1.51	1.69	1.72	1.72

(A) Represents the operations of our predecessor through the date of commencement of our operations, July 12, 2002.

For purposes of calculating the above ratios, (i) earnings represent “Income before equity in earnings of unconsolidated subsidiaries” from our consolidated statements of income, as adjusted for fixed charges and distributions from unconsolidated subsidiaries, and (ii) fixed charges represent “Interest expense” from our consolidated statements of income. The ratios are based solely on historical financial information.

These ratios are affected by increasing interest rates. As a result of our match funded financing strategy, increasing interest rates are expected to generally result in an increase to interest expense without a material effect on net income, thereby negatively impacting these ratios.

Exhibit 21.1

NEWCASTLE INVESTMENT CORP. SUBSIDIARIES

	STATE/COUNTRY OF INCORPORATION/FORMATION
1. 2520 Ridgewood GP, LLC	Texas
2. Commercial Asset Holdings LLC	Delaware
3. DBNC Peach Holding LLC	Delaware
4. DBNC Peach I Trust	Delaware
5. DBNC Peach LLC	Delaware
6. DBNCF Circle LLC	Delaware
7. DBNCH Circle LLC	Delaware
8. Fortress Asset Trust	Delaware
9. Fortress CBO Holdings I Inc.	Delaware
10. Fortress CBO Investments I Corp.	Delaware
11. Fortress CBO Investments I, Ltd.	Cayman Islands
12. Fortress Realty Holdings, Inc.	Ontario
13. Impac CMB Trust 1998-C1	Delaware
14. Impac Commercial Assets Corporation	California
15. Impac Commercial Capital Corporation	California
16. Impac Commercial Holdings, Inc.	Maryland
17. Karl S.A.	Belgium
18. LIV Holdings LLC	Delaware
19. NC Circle Holdings II LLC	Delaware
20. NC Circle Holdings LLC	Delaware
21. NCT Holdings II LLC	Delaware
22. NCT Holdings LLC	Delaware
23. Newcastle 2005-1 Asset-Backed Note LLC	Delaware
24. Newcastle 2006-1 Asset-Backed Note LLC	Delaware
25. Newcastle 2006-1 Depositor LLC	Delaware
26. Newcastle CDO Holdings LLC	Delaware
27. Newcastle CDO I Corp.	Delaware
28. Newcastle CDO I, Ltd.	Cayman Islands
29. Newcastle CDO II Corp.	Delaware
30. Newcastle CDO II Holdings LLC	Delaware
31. Newcastle CDO II, Ltd.	Cayman Islands
32. Newcastle CDO III Corp.	Delaware
33. Newcastle CDO III Holdings LLC	Delaware
34. Newcastle CDO III, Ltd.	Cayman Islands
35. Newcastle CDO IV Corp.	Delaware
36. Newcastle CDO IV Holdings LLC	Delaware
37. Newcastle CDO IV, Ltd.	Cayman Islands
40. Newcastle CDO V Corp.	Delaware
41. Newcastle CDO V Holdings LLC	Delaware

Exhibit 21.1

NEWCASTLE INVESTMENT CORP. SUBSIDIARIES

	STATE/COUNTRY OF INCORPORATION/FORMATION
42. Newcastle CDO V, Ltd.	Cayman Islands
43. Newcastle CDO VI , Ltd.	Cayman Islands
44. Newcastle CDO VI Corp.	Delaware
45. Newcastle CDO VI Holding, LLC	Delaware
46. Newcastle CDO VII Corp.	Delaware
47. Newcastle CDO VII Holdings LLC	Delaware
48. Newcastle CDO VII, Limited	Cayman Islands
49. Newcastle CDO VIII 1, Limited	Cayman Islands
50. Newcastle CDO VIII 2, Limited	Cayman Islands
51. Newcastle CDO VIII Holdings LLC	Delaware
52. Newcastle CDO VIII LLC	Delaware
53. Newcastle Foreign TRS LLC	Cayman Islands
54. Newcastle MH I LLC	Delaware
55. Newcastle Mortgage Securities LLC	Delaware
56. Newcastle Mortgage Securities Trust 2004-1	Delaware
57. Newcastle Mortgage Securities Trust 2006-1	Delaware
58. Newcastle Trust I	Delaware
59. NIC 2 River Place LLC	Delaware
60. NIC 4 River Place LLC	Delaware
61. NIC Airport Corporate Center LLC	Delaware
62. NIC Apple Valley I LLC	Delaware
63. NIC Apple Valley II LLC	Delaware
64. NIC Apple Valley III LLC	Delaware
65. NIC BR LLC	Delaware
66. NIC CNL LLC	Delaware
67. NIC CR LLC	Delaware
68. NIC CSR LLC	Delaware
69. NIC Dayton Towne Center LLC	Delaware
70. NIC DBRepo LLC	Delaware
71. NIC DP LLC	Delaware
72. NIC GCMRepo LLC	Delaware
73. NIC GR LLC	Delaware
74. NIC GS LLC	Delaware
75. NIC GSE LLC	Delaware
76. NIC Holdings I LLC	Delaware
77. NIC KZ LLC	Delaware
78. NIC NK LLC	Delaware
79. NIC OTC LLC	Delaware
80. NIC TRS Holdings, Inc.	Delaware
81. NIC TRS LLC	Delaware
82. NIC WL LLC	Delaware
83. Steinhage B.V.	Netherlands
84. Windsor Funding Trust	Delaware
85. Windsor Trust	Delaware

EXHIBIT 23.1

Consent of Independent Registered Public Accounting Firm

We consent to the incorporation by reference in the Registration Statement (Form S-3 No. 333-140840) of Newcastle Investment Corp. and in the related Prospectus of our reports dated February 22, 2007, with respect to the consolidated financial statements of Newcastle Investment Corp., Newcastle Investment Corp. management's assessment of the effectiveness of internal control over financial reporting, and the effectiveness of internal control over financial reporting of Newcastle Investment Corp., included in this Annual Report (Form 10-K) for the year ended December 31, 2006.

/s/ Ernst & Young

New York, NY
February 22, 2007

EXHIBIT 31.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER

I, Kenneth M. Riis, certify that:

1. I have reviewed this annual report on Form 10-K of Newcastle Investment Corp.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d - 15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d - 15(f)) for the registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

February 26, 2007
(Date)

/s/ Kenneth M. Riis
Kenneth M. Riis
Chief Executive Officer

EXHIBIT 31.2

CERTIFICATION OF CHIEF FINANCIAL OFFICER

I, Debra A. Hess, certify that:

1. I have reviewed this annual report on Form 10-K of Newcastle Investment Corp.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d - 15(f)) for the registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness o f 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, t o 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) 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.

February 26, 2007
(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 Annual Report on Form 10-K of Newcastle Investment Corp. (the "Company") for the annual period ended December 31, 2006 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Kenneth M. Riis, as Chief Executive Officer of the Company, hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of his knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Kenneth M. Riis
Kenneth M. Riis
Chief Executive Officer
February 26, 2007

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

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

EXHIBIT 32.2

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

In connection with the Annual Report on Form 10-K of Newcastle Investment Corp. (the "Company") for the annual period ended December 31, 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
February 26, 2007

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.