Resource Capital Corp.
Form 10-Q
May 12, 2006

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

FORM 10-Q

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

For the quarterly period ended March 31, 2006

OR

o **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: 1-32733

RESOURCE CAPITAL CORP.
(Exact name of registrant as specified in its charter)

Maryland	**20-2287134**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
712 5th Avenue, 10th Floor New York, NY	**10019**
(Address of principal executive offices)	(Zip Code)

212-506-3870
(Registrant's telephone number, including area code)

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. x Yes ¨ No

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

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer x

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

The number of outstanding shares of the registrant's common stock on May 1, 2006 was 17,815,150 shares.

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RESOURCE CAPITAL CORP. AND SUBSIDIARIES
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ON FORM 10-Q

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

RESOURCE CAPITAL CORP. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share data)

	March 31, 2006 (Unaudited)	December 31, 2005
ASSETS		
Cash and cash equivalents	$ 23,671	$ 17,729
Restricted cash	20,040	23,592
Due from broker	–	525
Available-for-sale securities, pledged as collateral, at fair value	1,185,485	1,362,392
Available-for-sale securities, at fair value	42,873	28,285
Loans, net of allowances of $0 and $0	683,908	570,230
Direct financing leases and notes, net of unearned income	61,539	23,317
Derivatives, at fair value	4,985	3,006
Interest receivable	10,639	9,337
Accounts receivable	148	183
Principal paydowns receivables	3,382	5,805
Other assets	2,216	1,146
Total assets	$ 2,038,886	$ 2,045,547
LIABILITIES		
Repurchase agreements, including accrued interest of $1,485 and $2,104	$ 917,293	$ 1,068,277
Collateralized debt obligations (“CDOs”)	687,686	687,407
Warehouse agreement	132,793	62,961
Secured term facility	55,767	–
Unsecured revolving credit facility	–	15,000
Distribution payable	5,878	5,646
Accrued interest expense	9,004	9,514
Management and incentive fee payable – related party	726	896
Security deposits	1,011	–
Accounts payable and accrued liabilities	851	513
Total liabilities	1,811,009	1,850,214
STOCKHOLDERS’ EQUITY		
Preferred stock, par value $0.001: 100,000,000 shares authorized; no shares issued and outstanding	-	-
Common stock, par value $0.001: 500,000,000 shares authorized; 17,813,096 and 15,682,334 shares issued and outstanding (including 234,224 and 349,000 restricted shares)	18	16
Additional paid-in capital	247,683	220,161
Deferred equity compensation	(1,936)	(2,684)
Accumulated other comprehensive loss	(14,582)	(19,581)
Distributions in excess of earnings	(3,306)	(2,579)
Total stockholders’ equity	$ 227,877	$ 195,333
TOTAL LIABILITIES AND STOCKHOLDERS’ EQUITY	$ 2,038,886	$ 2,045,547

See accompanying notes to consolidated financial statements

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RESOURCE CAPITAL CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except share and per share data)

	Three Months Ended March 31, 2006 (Unaudited)	Period from March 8, 2005 (Date Operations Commenced) to March 31, 2005
REVENUES		
Net interest income:		
Interest income from securities available-for-sale	$ 16,372	$ 404
Interest income from loans	11,019	–
Interest income – other	2,042	290
Total interest income	29,433	694
Interest expense	21,202	210
Net interest income	8,231	484
OTHER REVENUE		
Net realized loss on investments	(699)	–
EXPENSES		
Management fee expense – related party	993	208
Equity compensation expense – related party	582	209
Professional services	261	22
Insurance expense	120	30
General and administrative	426	63
Total expenses	2,382	532
NET INCOME (LOSS)	$ 5,150	$ (48)
NET INCOME (LOSS) PER SHARE - BASIC	$ 0.31	$ (0.00)
NET INCOME (LOSS) PER SHARE - DILUTED	$ 0.31	$ (0.00)
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING – BASIC	16,617,808	15,333,334
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING – DILUTED	16,752,520	15,333,334
DIVIDENDS DECLARED PER SHARE	$ 0.33	$ 0.00

See accompanying notes to consolidated financial statements

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RESOURCE CAPITAL CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
THREE MONTHS ENDED MARCH 31, 2006
(in thousands, except share data)
(Unaudited)

	Common Stock								
	Shares	Amount	Additional Paid-In Capital	Deferred Equity Compensation	Accumulated Other Comprehensive Loss	Retained Earnings	Distributions in Excess of Earnings	Comprehensive Loss	Total Stockholders' Equity
Balance, January 1, 2006	15,682,334	$ 16	$ 220,161	$ (2,684)	$ (19,581)	$ –	$ (2,579)	$ (19,581)	$ 195,333
Net proceeds from common stock offerings	2,120,800	2	29,663						29,665
Offering costs			(2,061)						(2,061)
Stock based compensation	9,962		146	(60)					86
Stock based compensation, fair value adjustment			(226)	226					–
Amortization of stock based compensation				582					582
Net income						5,150		5,150	5,150
Available-for-sale securities, fair value adjustment					2,619			2,619	2,619
Designated derivatives, fair value adjustment					2,380			2,380	2,380
Distributions - Common Stock						(5,150)	(727)		(5,877)
Comprehensive loss								$ (9,432)	
Balance, March 31, 2006	17,813,096	$ 18	$ 247,683	$ (1,936)	$ (14,582)	$ –	$ (3,306)		$ 227,877

See accompanying notes to consolidated financial statements

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RESOURCE CAPITAL CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(Unaudited)

	Three Months Ended March 31, 2006	Period from March 8, 2005 (Date Operations Commenced) to March 31, 2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	$ 5,150	$ (48)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	56	–
Amortization of premium (discount) on investments	(157)	(6)
Amortization of debt issuance costs	279	–
Amortization of stock based compensation	582	209
Non-cash incentive compensation to the manager	31	–
Net realized gain on derivative instruments	(480)	–
Net realized loss on investments	699	–
Changes in operating assets and liabilities:		
Decrease in restricted cash	3,552	–
Increase in interest receivable, net of purchased interest	(1,449)	(405)
Decrease in accounts receivable	35	–
Decrease in due from broker	525	–
Decrease in principal paydowns receivable	2,423	–
(Decrease) increase in management and incentive fee payable	(114)	208
Increase in offering costs payable	–	237
Increase in security deposits	1,011	–
Increase in accounts payable and accrued liabilities	328	83
(Decrease) increase in accrued interest expense	(1,129)	210
Decrease (increase) in other assets	86	(453)
Net cash provided by operating activities	11,428	35
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of securities available-for-sale	(4,724)	(502,850)
Principal payments received on securities available-for-sale	36,942	–
Proceeds from sale of securities available-for-sale	131,577	–
Purchase of loans	(186,929)	–
Principal payments received on loans	37,685	–
Proceeds from sale of loans	34,543	–
Purchase of direct financing leases and notes	(42,247)	–
Proceeds from and payments received on direct financing leases and notes	4,594	–
Net cash provided by (used in) investing activities	11,441	(502,850)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net proceeds from issuance of common stock (net of offering costs of $2,06 and $541)	27,604	214,661
Proceeds from borrowings:		
Repurchase agreements	2,622,885	400,753

Warehouse agreements		69,832		–
Secured term facility		55,767		–
Payments on borrowings:				
Repurchase agreements		(2,773,250)		–
Unsecured revolving credit facility		(15,000)		–
Settlement of derivative instruments		881		–
Distributions paid on common stock		(5,646)		–
Net cash (used in) provided by financing activities		(16,927)		615,414
NET INCREASE IN CASH AND CASH EQUIVALENTS		5,942		112,599
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD		17,729		–
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$	23,671	$	112,599
NON-CASH INVESTING AND FINANCING ACTIVITIES:				
Distributions on common stock declared but not paid	$	5,877	$	–
Issuance of restricted stock	$	–	$	5,393
SUPPLEMENTAL DISCLOSURE:				
Interest expense paid in cash	$	32,413	$	–

See accompanying notes to consolidated financial statements

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RESOURCE CAPITAL CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2006
(Unaudited)

NOTE 1 - ORGANIZATION

Resource Capital Corp. and subsidiaries (the ‘‘Company’’) was incorporated in Maryland on January 31, 2005 and commenced its operations on March 8, 2005 upon receipt of the net proceeds from a private placement of shares of its common stock. The Company’s principal business activity is to purchase and manage a diversified portfolio of real estate-related assets and commercial finance assets. The Company’s investment activities are managed by Resource Capital Manager, Inc. (‘‘Manager’’) pursuant to a management agreement (‘‘Management Agreement’’) (see Note 9). The Manager is a wholly-owned indirect subsidiary of Resource America, Inc. (“RAI”) (Nasdaq: REXI).

The Company intends to elect to be taxed as a real estate investment trust (‘‘REIT’’) for federal income tax purposes effective for its initial taxable year ending December 31, 2005 and to comply with the provisions of the Internal Revenue Code of 1986, as amended (‘‘Code’’) with respect thereto. See Note 3 for further discussion on income taxes.

The Company has three wholly-owned subsidiaries: RCC Real Estate, Inc. (“RCC Real Estate”), RCC Commercial, Inc. (“RCC Commercial”) and Resource TRS, Inc. (“Resource TRS”). As of March 31, 2006, there was no activity in Resource TRS. RCC Real Estate holds all of the Company’s real estate investments, including commercial and residential real estate-related securities and real estate loans. RCC Real Estate owns 100% of the equity interest in Ischus CDO II, Ltd. (“Ischus CDO II”), a Cayman Islands limited liability company and qualified REIT subsidiary (“QRS”). Ischus CDO II was established to complete a collateralized debt obligation (“CDO”) issuance secured by a portfolio of mortgage-backed and other asset-backed securities. RCC Commercial holds all of the Company’s syndicated loan investments and equipment leases and notes. RCC Commercial owns 100% of the equity interest in Apidos CDO I, Ltd. (“Apidos CDO I”), a Cayman Islands limited liability company and taxable REIT subsidiary (“TRS”). Apidos CDO I was established to complete a CDO secured by a portfolio of syndicated bank loans. As of March 31, 2006, the Company had also formed Apidos CDO III, Ltd. (“Apidos CDO III”), a Cayman Islands limited liability company that the Company intends to elect to be treated as a TRS. RCC Commercial intends to purchase 100% of the equity interest in Apidos CDO III. Apidos CDO III was established to complete a CDO that will be secured by a portfolio of syndicated bank loans.

NOTE 2 - BASIS OF PRESENTATION

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (“GAAP”). The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries and entities which are variable interest entities (“VIE’s”) in which the Company is the primary beneficiary under Financial Accounting Standards Board (“FASB”) Interpretation No. 46R, “Consolidation of Variable Interest Entities” (“FIN 46-R”). In general, FIN 46-R requires an entity to consolidate a VIE when the entity holds a variable interest in the VIE and is deemed to be the primary beneficiary of the VIE. An entity is the primary beneficiary if it absorbs a majority of the VIE’s expected losses, receives a majority of the VIE’s expected residual returns, or both.

Ischus CDO II, Apidos CDO I and Apidos CDO III are VIEs and are not considered to be qualifying special-purpose entities as defined by Statement of Financial Accounting Standards (“SFAS”) No. 140, “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, (“SFAS No. 140”). The Company owns 100% of the equity (“preference shares”) issued by Ischus CDO II and Apidos CDO I and has provided a guarantee of the first $20.0 million in losses for Apidos CDO III. As a result, the Company has determined it is the primary beneficiary of these entities and has included the accounts of these entities in the consolidated financial statements. See Note 3 for a

further discussion of our VIEs.

All significant intercompany balances and transactions have been eliminated in consolidation.

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RESOURCE CAPITAL CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2006 – (Continued)
(Unaudited)

NOTE 2 - BASIS OF PRESENTATION – (Continued)

The consolidated financial statements and the information and tables contained in the notes to the consolidated financial statements are unaudited. However, in the opinion of management, these interim financial statements include all adjustments necessary to fairly present the results of the interim periods presented. The unaudited interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the period ended December 31, 2005. The results of operations for the three months ended March 31, 2006 may not necessarily be indicative of the results of operations for the full year ending December 31, 2006.

NOTE 3 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Estimates affecting the accompanying consolidated financial statements include the fair values of the Company's investments and derivatives and the estimated life used to calculate amortization and accretion of premiums and discounts, respectively, on investments.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand and all highly liquid investments with original maturities of three months or less (temporary cash investments) at the time of purchase, which are held at financial institutions.

Restricted Cash

Restricted cash consists of $12.6 million of principal and interest payments collected on investments held in two CDO trusts, a $1.7 million credit facility reserve used to fund future investments that will be acquired by the Company's syndicated loan CDO trust and a $100,000 expense reserve used to cover CDO operating expenses. The remaining $5.6 million consists of $5.0 million of cash held in escrow in conjunction with Apidos CDO III, a CDO transaction expected to close in the second quarter of 2006 and a $564,000 interest reserve held on behalf of the Company's equipment leases.

Due from Broker

Amounts due from broker generally represent cash balances held with brokers as part of margin requirements related to hedging agreements.

Securities Available-for-Sale

SFAS No. 115, ''Accounting for Certain Investments in Debt and Equity Securities'' (''SFAS No. 115''), requires the Company to classify its investment portfolio as either trading investments, available-for-sale investments or held-to-maturity investments. Although the Company generally plans to hold most of its investments to maturity, it

may, from time to time, sell any of its investments due to changes in market conditions or in accordance with its investment strategy. Accordingly, SFAS No. 115 requires the Company to classify all of its investment securities as available-for-sale. All investments classified as available-for-sale are reported at fair value, based on market prices provided by dealers, with unrealized gains and losses reported as a component of accumulated other comprehensive income (loss) in stockholders' equity.

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RESOURCE CAPITAL CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2006 – (Continued)
(Unaudited)

NOTE 3 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – (Continued)

Securities Available-for-Sale – (Continued)

The Company evaluates its available-for-sale investments for other-than-temporary impairment charges under SFAS No. 115, in accordance with Emerging Issues Task Force (''EITF'') 03-1, ''The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments.'' SFAS No. 115 and EITF 03-1 requires an investor to determine when an investment is considered impaired (i.e., a decline in fair value below its amortized cost), evaluate whether that impairment is other than temporary (i.e., the investment value will not be recovered over its remaining life), and, if the impairment is other than temporary, recognize an impairment loss equal to the difference between the investment's cost and its fair value. SFAS No. 115 also includes accounting considerations subsequent to the recognition of an other-than-temporary impairment and requires certain disclosures about unrealized losses that have not been recognized as other-than-temporary impairments.

Investment securities transactions are recorded on the trade date. Purchases of newly issued securities are recorded when all significant uncertainties regarding the characteristics of the securities are removed, generally shortly before settlement date. Realized gains and losses on investment securities are determined on the specific identification method.

Securities Interest Income Recognition

Interest income on the Company's mortgage-backed and other asset-backed securities is accrued using the effective yield method based on the actual coupon rate and the outstanding principal amount of the underlying mortgages or other assets. Premiums and discounts are amortized or accreted into interest income over the lives of the securities also using the effective yield method (or a method that approximates effective yield), adjusted for the effects of estimated prepayments based on SFAS No. 91, ''Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases.'' For an investment purchased at par, the effective yield is the contractual interest rate on the investment. If the investment is purchased at a discount or at a premium, the effective yield is computed based on the contractual interest rate increased for the accretion of a purchase discount or decreased for the amortization of a purchase premium. The effective yield method requires the Company to make estimates of future prepayment rates for its investments that can be contractually prepaid before their contractual maturity date so that the purchase discount can be accreted, or the purchase premium can be amortized, over the estimated remaining life of the investment. The prepayment estimates that the Company uses directly impact the estimated remaining lives of its investments. Actual prepayment estimates are reviewed as of each quarter end or more frequently if the Company becomes aware of any material information that would lead it to believe that an adjustment is necessary. If prepayment estimates are incorrect, the amortization or accretion of premiums and discounts may have to be adjusted, which would have an impact on future income.

Loans

The Company purchases participations in corporate leveraged loans and commercial real estate loans in the secondary market and through syndications of newly originated loans. Loans are held for investment; therefore, the Company initially records them at their purchase prices, and subsequently accounts for them based on their outstanding principal plus or minus unamortized premiums or discounts. In certain instances, where the credit fundamentals underlying a particular loan have changed in such a manner that the Company's expected return on investment may decrease, the

Company may sell a loan held for investment due to adverse changes in credit fundamentals. Once the determination has been made by the Company that it no longer will hold the loan for investment, the Company will identify these loans as “loans held for sale” and will account for these loans at the lower of amortized cost or market value.

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RESOURCE CAPITAL CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2006 – (Continued)
(Unaudited)

NOTE 3 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – (Continued)

Loan Interest Income Recognition

Interest income on loans includes interest at stated rates adjusted for amortization or accretion of premiums and discounts. Premiums and discounts are amortized or accreted into income using the effective yield method. When the Company purchases a loan or pool of loans at a discount, it considers the provisions of AICPA Statement of Position (‘‘SOP’’) 03-3 ‘‘Accounting for Certain Loans or Debt Securities Acquired in a Transfer’’ to evaluate whether all or a portion of the discount represents accretable yield. If a loan with a premium or discount is prepaid, the Company immediately recognizes the unamortized portion as a decrease or increase to interest income.

Allowance and Provision for Loan Losses

To estimate the allowance for loan losses, the Company first identifies impaired loans. Loans are generally evaluated for impairment individually, but loans purchased on a pooled basis with relatively smaller balances and substantially similar characteristics may be evaluated collectively for impairment. The Company considers a loan to be impaired when, based on current information and events, management believes it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. When a loan is impaired, the allowance for loan losses is increased by the amount of the excess of the amortized cost basis of the loan over its fair value. Fair value may be determined based on market price, if available; the fair value of the collateral less estimated disposition costs; or the present value of estimated cash flows. Increases in the allowance for loan losses are recognized in the statements of operations as a provision for loan losses. A charge-off or write-down of a loan is recorded, and the allowance for loan losses is reduced, when the loan or a portion thereof is considered uncollectible and of such little value that further pursuit of collection is not warranted.

An impaired loan may be left on accrual status during the period the Company is pursuing repayment of the loan; however, the loan is placed on non-accrual status at such time as: (1) management believes that scheduled debt service payments will not be met within the coming 12 months; (2) the loan becomes 90 days delinquent; (3) management determines the borrower is incapable of, or has ceased efforts toward, curing the cause of the impairment; or (4) the net realizable value of the loan’s underlying collateral approximates the Company’s carrying value of such loan. While on non-accrual status, interest income is recognized only upon actual receipt.

As of March 31, 2006, the Company had not recorded an allowance for loan losses. At March 31, 2006, all of the Company’s loans are current with respect to the scheduled payments of principal and interest. In reviewing the portfolio of loans and the observable secondary market prices, the Company did not identify any loans that exhibit characteristics indicating that impairment has occurred.

Direct Financing Leases and Notes

The Company invests in small- and middle-ticket equipment leases and notes. Investments in leases are recorded in accordance with SFAS No. 13, “Accounting for Leases,” as amended and interpreted. Direct financing leases and notes transfer substantially all benefits and risks of equipment ownership to the customer. The Company’s investment in direct financing leases consists of the sum of the total future minimum lease payments receivable, less unearned finance income. Unearned finance income, which is recognized over the term of the lease and financing by utilizing the effective interest method, represents the excess of the total future minimum lease payments and contract payments

over the cost of the related equipment. The Company's investment in notes receivable consists of the sum of the total future minimum loan payments receivable less unearned finance income.

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RESOURCE CAPITAL CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2006 – (Continued)
(Unaudited)

NOTE 3 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – (Continued)

Credit and Market Risk

The Company's investments as of March 31, 2006, consist of mortgage-backed and other asset-backed securities, participations in corporate leveraged loans and commercial real estate loans and equipment leases and notes. The mortgage-backed and other asset-backed securities are securities that pass through collections of principal and interest from either underlying mortgages or other secured assets. Therefore, these securities may bear some exposure to credit loss. The Company mitigates some of this risk by holding a significant portion of its assets in securities that are issued by the Federal Home Loan Mortgage Corporation (''FHLMC'') and the Federal National Mortgage Association (''FNMA''). The payment of principal and interest on these securities is guaranteed by the respective issuing agencies. In addition, the Company's leveraged loans and commercial real estate loans may bear exposure to credit loss.

The Company bears certain other risks typical in investing in a portfolio of mortgage-backed and other asset-backed securities. Principal risks potentially affecting the Company's consolidated financial position, consolidated results of operations and consolidated cash flows include the risks that: (a) interest rate changes can negatively affect the market value of the Company's mortgage-backed and other asset-backed securities, (b) interest rate changes can influence decisions made by borrowers on the mortgages underlying the securities to prepay those mortgages, which can negatively affect both cash flows from, and the market value of, the securities, and (c) adverse changes in the market value of the Company's mortgage-backed securities and/or the inability of the Company to renew short-term borrowings can result in the need to sell securities at inopportune times and incur realized losses.

Borrowings

The Company finances the acquisition of its investments, including securities available-for-sale and loans, primarily through the use of secured borrowings in the form of repurchase agreements, warehouse agreements, CDOs, secured term facilities and an unsecured revolving credit facility. The Company may use other forms of secured borrowing in the future. The Company recognizes interest expense on all borrowings on an accrual basis.

Accounting for Certain Mortgage-Backed Securities and Related Repurchase Agreements

In certain circumstances, the Company has purchased debt investments from a counterparty and subsequently financed the acquisition of those debt investments through repurchase agreements with the same counterparty. The Company currently records the acquisition of the debt investments as assets and the related repurchase agreements as financing liabilities gross on the consolidated balance sheets. Interest income earned on the debt investments and interest expense incurred on the repurchase obligations are reported gross on the consolidated income statements. However, under a certain technical interpretation of SFAS 140, such transactions may not qualify as a purchase. The Company believes, and it is industry practice, that it is accounting for these transactions in an appropriate manner. However, the result of this technical interpretation would prevent the Company from presenting the debt investments and repurchase agreements and the related interest income and interest expense on a gross basis on the Company's consolidated financial statements. Instead, the Company would present the net investment in these transactions with the counterparty and a derivative with the corresponding change in fair value of the derivative being recorded through earnings. The value of the derivative would reflect changes in the value of the underlying debt investments and changes in the value of the underlying credit provided by the counterparty. As of March 31, 2006, the Company had no transactions in mortgage-backed securities where debt instruments were financed with the same counterparty.

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RESOURCE CAPITAL CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2006 – (Continued)
(Unaudited)

NOTE 3 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – (Continued)

Comprehensive Income (Loss)

Comprehensive income (loss) for the Company includes net income (loss) and the change in net unrealized gains (losses) on available-for-sale securities and derivative instruments used to hedge exposure to interest rate fluctuations and protect against declines in the market value of assets resulting from general trends in debt markets.

Income Taxes

The Company expects to operate in a manner that will allow it to qualify and be taxed as a REIT and to comply with the provisions of the Code with respect thereto. A REIT is generally not subject to federal income tax on that portion of its REIT taxable income (‘‘Taxable Income’’) which is distributed to its stockholders, provided that at least 90% of Taxable Income is distributed and certain other requirements are met. If the Company fails to meet these requirements and does not qualify for certain statutory relief provisions, it would be subject to federal income tax. The Company has a wholly-owned domestic subsidiary, Resource TRS, that the Company has elected to be treated as a TRS. For financial reporting purposes, current and deferred taxes are provided for on the portion of earnings recognized by the Company with respect to its interest in Resource TRS, a domestic taxable REIT subsidiary, because it is taxed as a regular subchapter C corporation under the provisions of the Code. As of March 31, 2006, Resource TRS did not have any taxable income. Apidos CDO I, the Company’s foreign TRS is organized as an exempted company incorporated with limited liability under the laws of the Cayman Islands, and is generally exempt from federal and state income tax at the corporate level because its activities in the United States are limited to trading in stock and securities for its own account. Therefore, despite its status as a TRS, it generally will not be subject to corporate tax on its earnings and no provision for income taxes is required; however because it is a “controlled foreign corporation,” the Company will generally be required to include Apidos CDO I’s current taxable income in its calculation of REIT taxable income. The Company also intends to make an election to treat Apidos CDO III as a TRS.

Stock Based Compensation

Pursuant to its 2005 Stock Incentive Plan (see Note 15), the Company granted 345,000 shares of restricted stock and options to purchase 651,666 shares of common stock to its Manager. A holder of the restricted shares has all of the rights of a stockholder of the Company, including the right to vote such shares and receive dividends. In 2005, the Company accounted for the restricted stock and stock options in accordance with EITF 96-18, ‘‘Accounting for Equity Instruments that are issued to other than Employees for Acquiring, or in Conjunction with Selling, Goods or Services,’’ (‘‘EITF 96-18’’) and SFAS No. 123 “Accounting for Stock-Based Compensation (“SFAS No. 123”). During 2006, the Company continued to apply the provisions of EITF 96-18, but effective January 1, 2006, the Company also adopted the provisions of SFAS No. 123(R) “Share-Based Payment” (“SFAS No. 123(R)”), which revises SFAS No. 123. Under SFAS No. 123(R), the Company’s compensation expense for options is accounted for using a fair-value-based method with the (non-cash) compensation expense being recorded in the financial statements over the vesting period. The Company elected to use the modified prospective transition method as permitted by SFAS No. 123(R) and, therefore, has not restated financial results for prior periods. The adoption of SFAS No. 123(R) did not have any significant impact on prior periods. In accordance with EITF 96-18, stocks and options are recorded in stockholders’ equity at fair value through an increase to additional paid-in-capital and an off-setting entry to deferred equity compensation (a contra-equity account). The deferred compensation is amortized over a three year graded vesting period with the amortization expense reflected as equity compensation expense. The unvested stock and options are adjusted quarterly

to reflect changes in fair value as performance under the agreement is completed. Any change in fair value is reflected in the equity compensation expense recognized in that quarter and in future quarters until the stock and options are fully vested.

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NOTE 3 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – (Continued)

Stock Based Compensation – (Continued)

On March 8, 2006 and 2005, the Company issued 4,224 shares and 4,000 shares of restricted stock to its non-employee directors, respectively. The stock awards vest one full year after the date of the grant. The Company accounts for this issuance using the fair value based methodology prescribed by SFAS No. 123(R). Pursuant to SFAS No. 123(R), the fair value of the award is measured on the grant date and recorded in stockholders' equity through an increase to additional paid-in capital and an offsetting entry to deferred equity compensation (a contra-equity account). This amount is not remeasured under the fair value based method. The deferred compensation is amortized and included in equity compensation expense.

Incentive Compensation

The Management Agreement provides for incentive compensation if the Company's financial performance exceeds certain benchmarks. See Note 9 for further discussion on the specific terms of the computation and payment of the incentive fee.

The incentive fee is paid up to 75% in cash and at least 25% in restricted stock. The cash portion of the incentive fee is accrued and expensed during the period for which it is calculated and earned. In accordance with SFAS No. 123(R) and EITF 96-18, the restricted stock portion of the incentive fee is also accrued and expensed during the period for which it is calculated and earned. Shares granted in connection with the incentive fee vest immediately. For the three months ended March 31, 2006, the Manager earned an incentive management fee of $113,000. No incentive was earned by the Manager for the period ended March 31, 2005. Based on the terms of the Management Agreement, the Manager will be paid its incentive management fee partially by the issuance of approximately 2,054 common shares and partially in cash totaling approximately $82,000. The incentive fee is payable in May 2006.

Net Income Per Share

In accordance with the provisions of SFAS No. 128, ''Earnings per Share,'' the Company calculates basic income per share by dividing net income for the period by weighted-average shares of its common stock, including vested restricted stock, outstanding for that period. Diluted income per share takes into account the effect of dilutive instruments, such as stock options, unvested restricted stock and warrants, but uses the average share price for the period in determining the number of incremental shares that are to be added to the weighted-average number of shares outstanding. (see Note 8).

Derivative Instruments

The Company's policies permit it to enter into derivative contracts, including interest rate swaps and interest rate caps to add stability to its interest expense and to manage its exposure to interest rate movements or other identified risks.

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RESOURCE CAPITAL CORP. AND SUBSIDIARIES
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(Unaudited)

NOTE 3 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – (Continued)

Derivative Instruments– (Continued)

The Company designates its derivative instruments as cash flow hedges and evaluates them at inception and on an ongoing basis in order to determine whether they qualify for hedge accounting. The hedge instrument must be highly effective in achieving offsetting changes in the hedged item attributable to the risk being hedged in order to qualify for hedge accounting. A hedge instrument is highly effective if changes in the fair value of the derivative provide an offset to at least 80% and not more than 125% of the changes in fair value or cash flows of the hedged item attributable to the risk being hedged. In accordance with SFAS No. 133, ‘‘Accounting for Derivative Instruments and Hedging Activities,’’ as amended and interpreted, the Company recognizes all derivatives as either assets or liabilities in the consolidated balance sheets and measures those instruments at their fair values. Any ineffectiveness which arises during the hedging relationship is recognized in interest expense during the period in which it arises. Before the end of the specified hedge time period, the effective portion of all contract gains and losses (whether realized or unrealized) is recorded in other comprehensive income or loss. Realized gains and losses on futures contracts are reclassified into earnings as an adjustment to interest expense during the specified hedge time period. Realized gains and losses on interest rate swap contracts are reclassified into earnings as an adjustment to interest expense during the period after the swap repricing date through the remaining maturity of the swap.

If the Company determines not to designate the interest rate swap and cap contracts as hedges and to monitor their effectiveness as hedges, or if the Company enters into other types of financial instruments that do not meet the criteria for designation as hedges, changes in the fair values of these instruments will be recorded in the consolidated statements of operations, potentially resulting in increased volatility in the Company’s earnings.

Variable Interest Entities

In December 2003, the FASB issued FIN 46-R. FIN 46-R addresses the application of Accounting Research Bulletin No. 51, ‘‘Consolidated Financial Statements,’’ to a VIE and requires that the assets, liabilities and results of operations of a VIE be consolidated into the financial statements of the enterprise that has a controlling financial interest in it. The interpretation provides a framework for determining whether an entity should be evaluated for consolidation based on voting interests or significant financial support provided to the entity (‘‘variable interests’’). The Company considers all counterparties to the transaction to determine whether a counterparty is a VIE and, if so, whether the Company’s involvement with the entity results in a variable interest in the entity. If the Company is determined to have a variable interest in the entity, an analysis is performed to determine whether the Company is the primary beneficiary.

On August 4, 2005, the Company terminated its Apidos CDO I warehouse agreement with Credit Suisse Securities (USA) LLC (“CS”) and the warehouse funding liability was replaced with the issuance of long-term debt by Apidos CDO I. The Company owns 100% of the equity issued by Apidos CDO I and is deemed to be the primary beneficiary. As a result, the Company consolidated Apidos CDO I at March 31, 2006.

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RESOURCE CAPITAL CORP. AND SUBSIDIARIES
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NOTE 3 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – (Continued)

Variable Interest Entities – (Continued)

On July 29, 2005, the Company terminated its Ischus CDO II warehouse agreement with CS and the warehouse funding liability was replaced with the issuance of long-term debt by Ischus CDO II. The Company owns 100% of the equity issued by Ischus CDO II and is deemed to be the primary beneficiary. As a result, the Company consolidated Ischus CDO II at March 31, 2006.

During July 2005, the Company entered into warehouse and master participation agreements with an affiliate of Citigroup Global Markets Inc. (“Citigroup”) providing that Citigroup will fund the purchase of loans by Apidos CDO III during the warehouse period in return for a participation interest in the interest earned on the loans of the London Inter-Bank Offered Rate (“LIBOR”) plus 0.25%. In addition, the agreements provide for a guarantee by the Company to Citigroup of the first $20.0 million in losses on the portfolio of bank loans. As of both March 31, 2006 and December 31, 2005, the Company had $5.0 million held in an escrow account in connection with the CDO. Upon review of the transaction, the Company determined that Apidos CDO III was a VIE under FIN 46-R and the Company is the primary beneficiary of the VIE. As a result, the Company consolidated Apidos CDO III as of March 31, 2006 and December 31, 2005, even though the Company does not own any of its equity. The impact of the consolidation of this VIE on the March 31, 2006 and December 31, 2005 consolidated balance sheets was to:

- increase loans, net of allowance, by $132.8 million and $63.0 million, respectively, which represents bank loans held by Apidos CDO III; and

- increase warehouse agreements by $132.8 million and $63.0 million, respectively, which represents the settlement of Apidos CDO III bank loans.

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RESOURCE CAPITAL CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 4 - SECURITIES AVAILABLE-FOR-SALE

The following tables summarize the Company's mortgage-backed securities, other asset-backed securities and private equity investments, including those pledged as collateral, classified as available-for-sale, which are carried at fair value (in thousands):

March 31, 2006:		**Amortized Cost**		**UnrealizedGains**		**Unrealized Losses**		**Estimated Fair Value**	
Agency residential mortgage-backed	$	853,536	$	–	$	(18,260)	$	835,276	
Non-agency residential mortgage-backed		345,038		1,477		(1,806)		344,709	
Commercial mortgage-backed		27,964		44		(993)		27,015	
Other asset-backed		21,558		52		(252)		21,358	
Total fair value	$	1,248,096	$	1,573	$	(21,311)	$	1,228,358	(1)
December 31, 2005:									
Agency residential mortgage-backed	$	1,014,575	$	13	$	(12,918)	$	1,001,670	
Non-agency residential mortgage-backed		346,460		370		(9,085)		337,745	
Commercial mortgage-backed		27,970		1		(608)		27,363	
Other asset-backed		22,045		24		(124)		21,945	
Private equity		1,984		–		(30)		1,954	
Total fair value	$	1,413,034	$	408	$	(22,765)	$	1,390,677	(1)

(1) Other than $42.9 million and $26.3 million in agency RMBS and $0 and $2.0 million in private equity investments, all securities are pledged as collateral as of March 31, 2006 and December 31, 2005, respectively.

The actual maturities of mortgage-backed securities are generally shorter than stated contractual maturities. Actual maturities of the Company's mortgage-backed securities are affected by the contractual lives of the underlying mortgages, periodic scheduled payments of principal, and prepayments of principal, which are presented in “principal paydowns receivable” in the Company’s consolidated balance sheets.

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RESOURCE CAPITAL CORP. AND SUBSIDIARIES
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MARCH 31, 2006 – (Continued)
(Unaudited)

NOTE 4 - SECURITIES AVAILABLE-FOR-SALE – (Continued)

The following tables summarize the estimated maturities of the mortgage-backed securities, other asset-backed securities and private equity investments according to their estimated weighted-average life classifications (in thousands, except percentages):

Weighted Average Life		Fair Value		Amortized Cost	Average Coupon
March 31, 2006:					
Less than one year	$	6,015	$	6,000	5.66%
Greater than one year and less than five years		1,179,956		1,198,799	5.02%
Greater than five years		42,387		43,297	5.76%
Total	$	1,228,358	$	1,248,096	5.05%
December 31, 2005:					
Less than one year	$	–	$	–	–%
Greater than one year and less than five years		1,355,910		1,377,537	4.91%
Greater than five years		34,767		35,497	5.60%
Total	$	1,390,677	$	1,413,034	4.92%

The estimated weighted-average lives of the Company’s mortgage-backed and other asset-backed securities are based upon data provided through subscription-based financial information services, assuming constant principal prepayment factors to the balloon or reset date for each security. The prepayment model considers current yield, forward yield, steepness of the yield curve, current mortgage rates, mortgage rate of the outstanding loan, loan age, margin and volatility. The actual weighted-average lives of the agency residential mortgage-backed securities in the Company's investment portfolio could be longer or shorter than the estimates in the table above depending on the actual prepayment factors experienced over the lives of the applicable securities and are sensitive to changes in both prepayment factors and interest rates.

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RESOURCE CAPITAL CORP. AND SUBSIDIARIES
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NOTE 4 - SECURITIES AVAILABLE-FOR-SALE – (Continued)

The following tables show the Company's investments' fair value and gross unrealized losses, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position (in thousands):

	Less than 12 Months		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
March 31, 2006:				
Agency residential mortgage-backed	$ 835,277	$ (18,260)	$ 835,277	$ (18,260)
Non-agency residential mortgage-backed	144,986	(1,806)	144,986	(1,806)
Commercial mortgage-backed	18,656	(993)	18,656	(993)
Other asset-backed	8,530	(252)	8,530	(252)
Total temporarily impaired securities	$ 1,007,449	$ (21,311)	$ 1,007,449	$ (21,311)
December 31, 2005:				
Agency residential mortgage-backed	$ 978,570	$ (12,918)	$ 978,570	$ (12,918)
Non-agency residential mortgage-backed	294,359	(9,085)	294,359	(9,085)
Commercial mortgage-backed	26,905	(608)	26,905	(608)
Other asset-backed	12,944	(124)	12,944	(124)
Private equity	1,954	(30)	1,954	(30)
Total temporarily impaired securities	$ 1,314,732	$ (22,765)	$ 1,314,732	$ (22,765)

The temporary impairment of the available-for-sale securities results from the fair value of the securities falling below the amortized cost basis and is solely attributed to changes in interest rates. As of March 31, 2006 and December 31, 2005, respectively, none of the securities held by the Company had been downgraded by a credit rating agency since their purchase. The Company intends and has the ability to hold the securities until the fair value of the securities held is recovered, which may be maturity if necessary. As such, the Company does not believe any of the securities held are other-than-temporarily impaired at March 31, 2006 and December 31, 2005, respectively.

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RESOURCE CAPITAL CORP. AND SUBSIDIARIES
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NOTE 5 - LOANS

The following is a summary of the Company’s loans at March 31, 2006 (in thousands).

Loan Description	Principal	Unamortized Premium	Net Amortized Cost
March 31, 2006:			
Syndicated loans	$ 470,792	$ 929	$ 471,721
A note	20,000	–	20,000
B notes	136,262	–	136,262
Mezzanine loans	55,925	–	55,925
Total	$ 682,979	$ 929	$ 683,908
December 31, 2005:			
Syndicated loans	$ 397,869	$ 916	$ 398,785
B notes	121,945	–	121,945
Mezzanine loans	49,500	–	49,500
Total	$ 569,314	$ 916	$ 570,230

At March 31, 2006, the Company’s syndicated loan portfolio consisted of $471.5 million of floating rate loans, which bear interest between LIBOR plus 1.38% and 7.50% with maturity dates ranging from September 2006 to December 2014, and a $249,000 fixed rate loan, which bears interest at 6.25% with a maturity date of September 2015.

At March 31, 2006, the Company’s commercial real estate loan portfolio consisted of:

- one A note with an amortized cost of $20.0 million which bears interest at a floating rate of LIBOR plus 1.25% with a maturity date of January 2008;

- eight B notes with an amortized cost of $136.3 million which bear interest at floating rates ranging from LIBOR plus 2.15% to LIBOR plus 6.25% and have maturity dates ranging from January 2007 to April 2008;

- four mezzanine loans with an amortized cost of $44.4 million which bear interest at floating rates between LIBOR plus 2.25% and LIBOR plus 4.50% with maturity dates ranging from August 2007 to July 2008;

- one mezzanine loan with an amortized cost of $6.5 million which bears interest at the 10-Year Treasury rate plus 6.64% with a maturity date of January 2016; and

- one mezzanine loan with an amortized cost of $5.0 million which bears interest at a fixed rate of 9.50% with a maturity of May 2010.

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RESOURCE CAPITAL CORP. AND SUBSIDIARIES
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NOTE 5 - LOANS – (Continued)

At December 31, 2005, the Company's syndicated loan portfolio consisted of $398.5 million of floating rate loans, which bear interest between LIBOR plus 1.00% and 7.00% with maturity dates ranging from April 2006 to October 2020, and a $250,000 fixed rate loan, which bears interest at 6.25% with a maturity date of August 2015.

At December 31, 2005, the Company's commercial real estate loan portfolio consisted of:

- seven B notes with an amortized cost of $121.9 million which bear interest at floating rates ranging from LIBOR plus 2.15% to LIBOR plus 6.25% and have maturity dates ranging from January 2007 to April 2008;

- four mezzanine loans with an amortized cost of $44.5 million which bear interest at floating rates between LIBOR plus 2.25% and LIBOR plus 4.50% with maturity dates ranging from August 2007 to July 2008; and

- one mezzanine loan with an amortized cost of $5.0 million which bears interest at a fixed rate of 9.50% with a maturity of May 2010.

As of March 31, 2006 and December 31, 2005, the Company had not recorded an allowance for loan losses. At March 31, 2006 and December 31, 2005, all of the Company's loans were current with respect to the scheduled payments of principal and interest. In reviewing the portfolio of loans and the observable secondary market prices, the Company did not identify any loans with characteristics indicating that impairment had occurred.

NOTE 6 -DIRECT FINANCING LEASES AND NOTES

The Company's direct financing leases have initial lease terms of 65 months and 54 months, as of March 31, 2006 and December 31, 2005, respectively. The interest rates on notes receivable range from 7% to 9% and 8% and 9%, as of March 31, 2006 and December 31, 2005, respectively. Investments in direct financing leases and notes, net of unearned income, were as follows (in thousands):

	As of March 31, 2006	**As of December 31, 2005**
Direct financin		