

Underwriting Standards

Described below are underwriting standards used by the Bank or its affiliates, as applicable, to originate loans that have been or may be transferred to us from the Bank or its affiliates. We do not have lending operations. The Bank or its applicable affiliates perform all of these lending and underwriting operations.

Commercial and Commercial Real Estate Loans. "Real estate loans" are loans secured by real estate and for which the primary source of repayment is based on the quality and sufficiency of a stream of rental income from the property. The income stream from a real estate loan either amortizes the loan or permits the property's sale or refinance. The Bank makes the following types of real estate loans:

- office (including multi-tenant, single tenant and condominiums);
- retail;
- apartments;
- commercial development;
- warehouse/industrial (including self-storage facilities);
- continuing care retirement communities;
- senior living facilities;
- lodging;
- loans to residential builders for the purpose of developing residential home sites or construction; and
- commercial and industrial real estate loans (where the primary source of repayment is based on the financial strength of the business operations or the borrower instead of the income stream from the real estate).

The Bank analyzes the borrower's creditworthiness, repayment capacity, and adequacy of the real property provided as collateral. For each product type listed above, the Bank utilizes underwriting guidelines for loan-to-value, debt service coverage and amortization. These guidelines are adjusted based upon the overall

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market conditions or local market-specific requirements. The Bank also takes into account the following factors when underwriting real estate loans:

- preference to lend to existing customers;
- the risk and return to the Bank on the use of its capital;
- preference to lend within its existing market in its franchise;
- secondary sources of repayment, including guarantees;
- the amount of borrower equity;
- preference for loan terms of three years or less;
- exposure limits per customer and project;
- knowledge of the repayment sources, including permanent loan conditions, interest rate sensitivity and property values;
- need for property type diversification in its portfolio; and
- preference against financing projects with speculative market risk.

Home Equity Loans. The Bank and Wachovia Bank of Delaware, National Association (a subsidiary of Wachovia and our affiliate, which we refer to as “Wachovia Delaware”), originate and underwrite, or purchase and re-underwrite, home equity loans secured by a first, second or third mortgage primarily on the borrower’s residence. The underwriting process is intended to assess both the prospective borrower’s ability to repay and the adequacy of the real property security as collateral for the loan. Factors analyzed in determining the borrower’s ability to repay the loan include:

- income;
- credit history (including credit scores and credit bureau information); and
- debt-to-income ratio.

Factors analyzed in determining the adequacy of the real property security include:

- Loan-to-Value Ratio;
- appraisals; and
- homeowners insurance.

Residential Mortgage Loans. Wachovia Mortgage Corporation, a subsidiary of Wachovia and an affiliate of the Bank and us, which we refer to as “Wachovia Mortgage”, originates and underwrites, or purchases and re-underwrites, consumer first mortgage loans. These loans typically are used to acquire or re-finance customers’ primary residences. Wachovia Mortgage’s underwriting criteria are focused primarily on secondary market guidelines. The underwriting process is intended to assess both the prospective borrower’s ability to repay and the adequacy of the real property security as collateral for the loan. Factors analyzed in determining the borrower’s ability to repay the loan include:

- stability of income;
- credit history (including credit scores and credit bureau information); and
- debt-to-income ratio.

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Factors analyzed in determining the adequacy of the real property security include:

- Loan-to-Value Ratio;
- appraisals; and
- homeowners and title insurance.

Asset Acquisition and Disposition Policies

It is our policy to purchase, or accept as capital contributions, loans or participation interests in loans from the Bank or its affiliates that generally are:

- performing, meaning they have no more than two payments past due, if any;
- in accrual status; and
- secured by real property such that they are REIT Qualified Assets.

Our policy also allows for investment in loans or assets which are not REIT Qualified Assets up to but not exceeding the statutory limitations imposed on organizations that qualify as a REIT under the Code. In the past, we have purchased or accepted as capital contributions loans and participation interests in loans both secured and not secured by real property along with other assets. We anticipate that we will acquire, or receive as capital contributions, interests in additional real estate secured loans from the Bank or its affiliates. We may from time to time acquire loans or loan participation interests from unaffiliated third parties. We may use any proceeds received in connection with the repayment or disposition of loan participation interests in our portfolio to acquire additional loans. Although we are not precluded from purchasing additional types of loans, loan participation interests or other assets, we anticipate that participation interests in additional loans acquired by us will be of the types described above under the heading “—General Description of Mortgage Assets and Other Authorized Investments; Investment Policy”. In addition, we will not invest in assets that are not REIT Qualified Assets if such investments would cause us to violate the requirements for taxation as a REIT under the Code.

We may from time to time acquire a limited amount of other authorized investments. Although we currently do not intend to acquire any mortgage-backed securities representing interests in or obligations backed by pools of mortgage loans that are secured by single-family residential, multi-family or commercial real estate properties located throughout the United States, we are not restricted from doing so. We do not intend to acquire any interest-only or principal-only mortgage-backed securities. At March 31, 2003, we did not hold any mortgage-backed securities.

We currently anticipate that the Bank or its affiliates will continue to act as servicer of any additional loans that we acquire through purchase or participation interests from the Bank or its affiliates. We anticipate that any servicing arrangement that we enter into in the future with the Bank or its affiliates will contain fees and other terms that most likely will be substantially equivalent to but may be more favorable to us than those that would be contained in servicing arrangements entered into with unaffiliated third parties. To the extent we acquire additional loans or participation interests directly from unaffiliated third parties, we anticipate that such loans or participation interests may be serviced by entities other than the Bank or its affiliates. It is our policy that any servicing arrangements with unaffiliated third parties will be consistent with standard industry practices.

In accordance with the terms of the commercial, commercial real estate and residential loan participation and servicing agreements, we maintain the authority to decide whether to foreclose on collateral that secures a loan. In the event we determine a foreclosure proceeding is appropriate, we may direct the Bank to prosecute the foreclosure on our behalf. Upon sale or other disposition of foreclosure property, the Bank will remit to us the proceeds less the cost of holding and selling the foreclosure property.

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For a description of our credit risk management policies, see below under “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Risk Governance and Administration”.

Conflict of Interest Policies

Because of the nature of our relationship with the Bank or its affiliates, it is likely that conflicts of interest will arise with respect to certain transactions, including, without limitation, our acquisition of participation interests in loans from, or disposition of participation interests in loans to, the Bank, foreclosure on defaulted loans, management of the cash collateral related to the interest rate swaps and the modification of either the participation or servicing agreements. It is our policy that the terms of any financial dealings with the Bank will be consistent with those available from third parties in the lending industry.

Conflicts of interest among us and the Bank or its affiliates may also arise in connection with making decisions that bear upon the credit arrangements that the Bank or its affiliates may have with a borrower under a loan. Conflicts also could arise in connection with actions taken by us or the Bank or its affiliates. It is our intention that any agreements and transactions between us on the one hand, and the Bank or its affiliates on the other hand, including, without limitation, any loan participation agreements, be fair to all parties and consistent with market terms for such types of transactions. The requirement in our certificate of incorporation that certain of our actions be approved by a majority of our Independent Directors also is intended to ensure fair dealings among us and the Bank or its affiliates. There can be no assurance, however, that any such agreement or transaction will be on terms as favorable to us as could have been obtained from unaffiliated third parties.

There are no provisions in our certificate of incorporation limiting any of our officers, directors, shareholders, or affiliates from having any direct or indirect pecuniary interest in any asset to be acquired or disposed of by us or in any transaction in which we have an interest or from engaging in acquiring, holding, and managing our assets. As described in this prospectus, it is expected that the Bank will have direct interests in transactions with us including, without limitation, the sale of assets to us; however, except as borrowers under home equity or residential mortgage loans, none of our officers or directors will have any interests in such mortgage assets.

Other Policies

We intend to operate in a manner that will not subject us to regulation under the Investment Company Act. Therefore, we do not intend to:

- invest in the securities of other issuers for the purpose of exercising control over such issuers;
- underwrite securities of other issuers;
- actively trade in loans or other investments;
- offer securities in exchange for property; or
- make loans to third parties, including our officers, directors or other affiliates.

The Investment Company Act exempts entities that, directly or through majority-owned subsidiaries, are “primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on and interests in real estate”. We refer to these interests as “Qualifying Interests”. Under current interpretations by the staff of the SEC, in order to qualify for this exemption, we, among other things, must maintain at least 55% of our assets in Qualifying Interests and also may be required to maintain an additional 25% in Qualifying Interests or other real estate-related assets. The assets that we may acquire therefore may be limited by the provisions of the Investment Company Act. We have established a policy of limiting authorized investments which are not Qualifying Interests to no more than 20% of the value of our total assets.

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We may, under certain circumstances, purchase the Series A preferred securities and other shares of capital stock in the open market or otherwise. We have no present intention of repurchasing any of our shares of capital stock, and any such action would be taken only in conformity with applicable Federal and state laws and regulations and the requirements for qualifying as a REIT.

We intend to distribute to our shareholders, in accordance with the Exchange Act, annual reports containing consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America and certified by our independent auditors. Our certificate of incorporation provides that we will maintain our status as a reporting company under the Exchange Act for so long as any of the Series A preferred securities are outstanding and held by unaffiliated shareholders.

We currently make investments and operate our business in such a manner consistent with the requirements of the Code to qualify as a REIT. However, future economic, market, legal, tax, or other considerations may cause our board of directors, subject to approval by a majority of our Independent Directors, to determine that it is in our best interest and the best interest of our shareholders to revoke our REIT status. The Code prohibits us from electing REIT status for the four taxable years following the year of such revocation.

Servicing

The loans in our portfolio are serviced by the Bank or its affiliates pursuant to the terms of participation and servicing agreements between the Bank and its affiliates and us. The Bank has delegated servicing responsibility of the residential mortgage loans to third parties that are not affiliated with us or the Bank or its affiliates.

We pay the Bank a monthly loan servicing fee for its services under the terms of the loan participation and servicing agreements. The amount and terms of the fee are determined by mutual agreement of the Bank and us from time to time during the terms of the participation and servicing agreements.

We paid the Bank total servicing fees of \$1.7 million in the first three months of 2003 and \$0.9 million, \$0.4 million and \$1.2 million for the years ended December 31, 2002, 2001 and 2000, respectively. For 2003, the annual servicing fee with respect to the commercial real estate and commercial loans is equal to the total committed amount of each loan multiplied by a fee of 0.03% and the annual servicing fee with respect to home equity loans is equal to the principal amount of each loan multiplied by a fee of 0.50%.

The participation and servicing agreements currently in place require the Bank to service the loans in our portfolio in a manner substantially the same as for similar work performed by the Bank for transactions on its own behalf. The Bank or its affiliates collect and remit principal and interest payments, maintain perfected collateral positions, and submit and pursue insurance claims. The Bank and its affiliates also provide accounting and reporting services required by us for our participation interests and loans. We also may direct the Bank to dispose of any loans that become classified as non-performing, placed in a non-performing status, or are renegotiated due to the financial deterioration of the borrower. The Bank is required to pay all expenses related to the performance of its duties under the participation and servicing agreements, including any payment to its affiliates or third parties for servicing the loans.

In accordance with the terms of the commercial, commercial real estate and residential loan participation and servicing agreements, we maintain the authority to decide whether to foreclose on collateral that secures a loan. In the event we determine a foreclosure proceeding is appropriate, we may direct the Bank to prosecute the foreclosure on our behalf. Upon sale or other disposition of foreclosure property, the Bank will remit to us the proceeds less the cost of holding and selling the foreclosure property.

To the extent we acquire loans or participation interests directly from unaffiliated third parties in the future, we may also enter into servicing agreements with such unaffiliated third parties or their affiliates.

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In order to qualify as a REIT under the Code, we can only be a passive investor in real estate loans and certain other assets. Thus, we do not originate loans. We anticipate that we will continue to possess interests in mortgage and other loans in addition to those in the current portfolio and that substantially all of these loans will be owned by the Bank, although we may also purchase loans from unaffiliated third parties. The Bank competes with mortgage conduit programs, investment banking firms, savings and loan associations, banks, thrift and loan associations, finance companies, mortgage bankers, or insurance companies in acquiring and originating loans. To the extent we acquire additional loans or participation interests directly from unaffiliated third parties in the future, we will face similar competition as the Bank in acquiring such loans or participation interests.

Regulatory Considerations

On July 30, 2002, President Bush signed the Sarbanes-Oxley Act of 2002 into law. The intent of this law is to reform specific matters pertaining to public accounting oversight, auditor independence and corporate responsibility. Requirements in the act will affect certain of Wachovia's corporate governance policies and certain of Wachovia's business lines, such as securities analysis. We do not believe we will need to make material modifications to our corporate governance policies in response to the act nor do we believe the act will negatively affect our financial condition or results of operations. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Risk Governance and Administration—Financial Disclosure" for a more complete description of certain of our and Wachovia's financial disclosure policies.

Various legislative and regulatory proposals concerning the financial services industry are pending in Congress, the legislatures in states in which we conduct operations, and before various regulatory agencies that supervise our operations. Given the uncertainty of the legislative and regulatory process, we cannot assess the impact of any such legislation or regulations on our financial condition or results of operations.

As a REIT, we are subject to regulation under the Code. The Code requires us to invest at least 75% of the total value of our assets in REIT Qualified Assets. See "Business—General Description of Mortgage Assets and Other Authorized Investments; Investment Policy" for more detailed descriptions of the requirements of the Code applicable to us. In addition, we intend to operate in a manner that will not subject us to regulation under the Investment Company Act. See "Business—Conflicts of Interest and Related Management Policies and Programs—Other Policies" for a more detailed description of the requirements we have to follow in order not to be subject to regulation under the Investment Company Act.

Under certain circumstances, including any determination that the Bank's relationship to us results in unsafe and unsound banking practices, the OCC has the authority to restrict our ability to make dividend payments to our shareholders. See "Business—Dividend Policy" for a more detailed description of such restrictions.

Moreover, our Series A preferred securities are automatically exchangeable for depositary shares representing Series G, Class A preferred stock of Wachovia at the direction of the OCC if any of the following events occurs:

- the Bank becomes undercapitalized under the OCC's "prompt corrective action" regulations;
- the Bank is placed into conservatorship or receivership; or
- the OCC, in its sole discretion, anticipates that the Bank may become "undercapitalized" in the near term or takes supervisory action that limits the payment of dividends by us and in connection therewith directs an exchange.

In an exchange, holders of our Series A preferred securities would receive one depositary share representing a one-sixth interest in one share of Wachovia Series G, Class A preferred stock for each of our

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Series A preferred securities. The Wachovia Series G, Class A preferred stock will be non-cumulative, perpetual, non-voting preferred stock of Wachovia. If such an exchange occurs, holders of our Series A preferred securities would own an investment in Wachovia and not in us at a time when the Bank's and, ultimately, Wachovia's financial condition is deteriorating or the Bank may have been placed into conservatorship or receivership.

As a financial holding company and a bank holding company under the Bank Holding Company Act, Wachovia is regulated, supervised and examined by the Federal Reserve Board. For a discussion of the material elements of the regulatory framework applicable to financial holding companies, bank holding companies and their subsidiaries and specific information relevant to Wachovia, please refer to Wachovia's annual report on Form 10-K for the fiscal year ended December 31, 2002, and any subsequent reports Wachovia files with the SEC, which are incorporated by reference in this prospectus. This regulatory framework is intended primarily for the protection of depositors and the Federal deposit insurance funds and not for the protection of security holders. As a result of this regulatory framework, Wachovia's earnings are affected by actions of the Federal Reserve Board, the OCC, which regulates its banking subsidiaries such as the Bank, the Federal Deposit Insurance Corporation, which insures the deposits of Wachovia's banking subsidiaries within certain limits, and the SEC, which regulates the activities of certain subsidiaries engaged in the securities business.

Wachovia's earnings are also affected by general economic conditions, its management policies and legislative action.

In addition, there are numerous governmental requirements and regulations that affect Wachovia's business activities. A change in applicable statutes, regulations or regulatory policy may have a material effect on Wachovia's business.

Depository institutions, like Wachovia's bank subsidiaries, are also affected by various Federal laws, including those relating to consumer protection and similar matters. Wachovia also has other financial services subsidiaries regulated, supervised and examined by the Federal Reserve Board, as well as other relevant state and Federal regulatory agencies and self-regulatory organizations. Wachovia's non-bank subsidiaries may be subject to other laws and regulations of the Federal government or the various states in which they are authorized to do business.

Legal Proceedings

Neither we nor our subsidiaries are the subject of any litigation. We, Wachovia and the Bank are not currently involved in nor, to our knowledge, currently threatened with any material litigation with respect to the assets included in our portfolio, other than routine litigation arising in the ordinary course of business. Based on information currently available, advice of counsel, available insurance coverage and established reserves, we believe that the eventual outcome of the actions with respect to the assets included in our portfolio will not, in the aggregate, have a material adverse effect on our consolidated financial position or results of operations. However, in the event of unexpected future developments, it is possible that the ultimate resolution of those matters, if unfavorable, may be material to our results of operations for any particular period.

Employees

We have 2 executive officers, each of whom is described further below under "Management," and approximately 15 additional non-executive officers. Our executive officers are also executive officers of Wachovia. We do not anticipate that we will require any additional employees because employees of the Bank and its affiliates are servicing the loans under the participation and servicing agreements. All of our officers are also officers or employees of Wachovia and/or the Bank. We maintain corporate records and audited financial statements that are separate from those of the Bank. Except as borrowers under home equity or

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residential mortgage loans, none of our officers, employees or directors will have any direct or indirect pecuniary interest in any mortgage asset to be acquired or disposed of by us or in any transaction in which we have an interest or will engage in acquiring, holding, and managing mortgage assets. However, 113 employees of Wachovia or its affiliates, including certain of the non-executive officers discussed above, own one Series D preferred security each.

Executive Offices

Our principal executive offices are located at 1620 East Roseville Parkway, Roseville, California 95661 (telephone number (877) 867-7378).

Web Site Access to SEC Filings

Although Wachovia Funding does not maintain its own website, our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act are accessible at no cost on Wachovia's website, www.wachovia.com, as soon as reasonably practicable after those reports have been electronically filed or submitted to the SEC. These filings are also accessible on the SEC's website, www.sec.gov.

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