UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

IN RE DYNEX CAPITAL, INC. SECURITIES LITIGATION	NO. 05-CV-1897-HB
	AMENDED CLASS ACTION COMPLAINT
	JURY TRIAL DEMANDED

NATURE OF THE ACTION

1. This securities class action is brought by plaintiff on behalf of purchasers in the aftermarket of Merit Securities Corporation's ("Merit") Collateralized Bonds Series 12 (the "Series 12 Bonds") and Series 13 Bonds (the "Series 13 Bonds") (the Series 12 and 13 Bonds, collectively the "Bonds") between February 7, 2000 and May 13, 2004 (the "Class Period"), seeking to pursue remedies under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 (the "Exchange Act"). See 15 U.S.C. §§ 78j(b) and 78t(a).

2. It is alleged that Dynex Capital, Inc ("Dynex"), a real estate investment company, through its subsidiaries including Merit, and its senior officers, defendants Thomas H. Potts ("Potts") and Stephen J. Benedetti ("Benedetti") engaged in a common fraudulent scheme to artificially inflate the price of the Bonds by misrepresenting the quality and manner in which the Bond's mobile home loan collateral was originated and underwritten and then, throughout the Class Period, to conceal the true impaired nature of that collateral by misrepresenting that the poor performance of the collateral in terms of delinquencies, defaults and loss severities (i.e., losses from repossessions) was the result of "market" conditions. Dynex also misrepresented, inter alia, that its need to increase its loan loss reserves to include "all loans greater than 30 days delinquent" and then "current" mobile home loans in 2003 and 2004, respectively, was only due to "recent" data. After years of the Bond collateral's consistently poor performance, the true

condition of the collateral became evident resulting in the Bonds being substantially downgraded by Moody's on February 24, 2004 (Series 13) and May 13, 2004 (Series 12) which caused dramatic Bond price declines of as much as 72%.

3. Plaintiff's allegations are based upon the investigation of plaintiff's counsel, including without limitation: (1) review of United States Securities and Exchange Commission ("SEC") filings by Merit and its parent, Dynex Capital, Inc. ("Dynex") (Merit and Dynex are herein collectively referred to as ("Dynex" or the "Company"); (2) securities analysts' and rating agency reports and advisories regarding the Bonds, Merit, Dynex and the Manufactured Housing Asset-Backed Securities market ("MH-ABS Market"); (3) press releases and other public statements issued by the Company and Dynex concerning the Bonds and its reported financial results; (4) reports and studies about the manufactured housing market and underwriting practices in connection with the purchase of manufacturing housing; and (5) former employees of Dynex, its subsidiaries and affiliates, including Dynex Financial Services, engaged in the areas of sales, origination and underwriting of manufactured housing loans in branch offices in various locations in the United States, as well as former employees engaged in the mobile home loan collection and repossession activities at Dynex's former loan servicing offices in Fort Worth, Texas; and individuals knowledgeable about the mobile home loan market and underwriting and origination practices during the relevant period. (See Sources For Fraud Allegations, ¶ 15, infra.)

INTRODUCTION

4. At all relevant times, Dynex was a real estate investment trust and was never principally engaged in the business of mobile home loan origination. Dynex's principal business

was the consummation of public offerings of debt securities using mortgages as collateral. Dynex thus "pooled" or packaged commercial, residential and other mortgages so that they could be "securitized" as collateral for bonds issued to public investors. These public bond issuances provided Dynex with the opportunity for not only the immediate influx of hundreds of millions of dollars to fund purchases of the mortgages used as collateral, but also the potential for further profit from the differential between what the typical yield (7% to 9%) paid to the bondholders and the interest (10% to 14%) received from the mortgages. Mobile home loan contracts or mortgages were not the predominant "vehicle" for Dynex's debt securities issuances. The more typical collateral for Dynex's public debt securities were commercial or residential mortgages. Indeed, of the fourteen bond issuances totaling approximately $10 billion Dynex originated between 1994 and 2000 only two issues (totaling $736.2 million or 7.3%) were composed entirely of mobile home loan collateral -- the Series 12 and Series 13 Bonds. Further, all of these offerings were consummated by year 1999 and by that same time -- year end 1999 -- Dynex had sold its mobile home origination business.

5. Thus, Dynex's purpose and presence in the mobile home loan business was both limited and short lived. Nevertheless, Dynex originated a massive quantity of mobile home loans (approximately 13,000) in this short two year period between 1996 and April 1999 in order to consummate the Bond Offerings. This rapid and massive origination of mobile home loans was achieved in the face of enormous market obstacles. By the late 1990s the mobile home loan market had become dominated by well established companies, such as Green Tree Financial Corporation ("Green Tree") and Green Point Financial Corporation ("Green Point"), with field

offices throughout the United States. These companies had long standing relationships with mobile home dealers that posed a significant barrier to entry to any "late comer" to the market. In fact, the Bond collateral was principally originated in Texas, North Carolina, Georgia, South Carolina and Michigan, which were all geographic areas Green Tree and Green Point had a well established presence. Moreover, the mobile home loan market was also plagued in the late 1990s with oversupply of mobile home product and the interrelated pervasive fraudulent practices of mobile home dealers seeking to "push through" financing for uncreditworthy purchasers in order to record sales and earn commissions. Dynex only overcame these obstacles, as set forth below, by the undisclosed practice of overtly marketing to mobile home dealers Dynex's willingness to buy "bad paper" or uncreditworthy loans; purchasing these highly defective and impaired loans; and then using them as the Bond collateral.

6. The Offering Documents issued in 1999 by Dynex in connection with the Series 12 and Series 13 Bonds belied the true facts concerning how the collateral was originated. These documents described delinquencies to be approximately 1.36% of the total loan balance (¶ 64) and were identical in assurances to investors that there were underwriting standards adhered to in the origination of this collateral, which included an evaluation of the Borrower's credit standing and repayment ability (e.g., mobile home loans are typically "made based upon a borrower's ability to make monthly payments" (¶ 67); based upon a review of specific supporting credit documentation (¶¶ 68-69)). The Offering Documents also described Dynex's role as "Master Servicer" of the loans including monitoring compliance with servicing guidelines which included reporting collateral performance to investors (¶ 80). As a result of these material assurances, the

Bonds were assigned by Moody's and Fitch among their highest ratings (Aaa and AAA, respectively) and traded at par or above from the time of the Offering in 1999 through year end 2003.

7. After the issuance of the Bonds in 1999 and throughout the Class Period beginning on February 7, 2000, Dynex never qualified or modified the descriptions regarding the origination of the Bond collateral contained in the Offering Documents. Instead, Dynex made numerous representations during the Class Period which reinforced the origination descriptions by claiming that the Bond collateral's deteriorating performance was due to "market conditions" including for example:

(a) In May 2001, that "manufacturing housing loans" were "currently experiencing higher loss severities than previously anticipated due to the depressed state of the manufactured housing sector" (¶ 84) and "as a result of the saturation in the market place with both new and used (repossessed) manufactured housing units" (¶¶ 84, 86, 87, 94, 100, 110);

(b) In April 2002, that high credit losses on its manufactured housing loan portfolio were "primarily related to the depressed market for repossessed manufactured homes, compounded by the exit from that market of several large lenders." (¶ 92); and

(c) In April 2003, that "the weakness in the manufactured housing market as a major contributor to the net loss for 2002." (¶ 96);

8. Dynex then claimed in April 2003 and April 2004 that it was only as a result of these recent "market events" and "new observable data" with respect to "performance and default activity" of the Bond collateral that it increased its loan loss reserves with respect to the

mobile home loan collateral to include "all loans greater than 30 days delinquent" (¶ 100) and then in April 2004 to include even "current" mobile home loans (¶ 110).

9. During the Class Period, Dynex also reiterated its role as "Master Servicer" of the mobile home loan collateral "monitoring" the compliance with "servicing guidelines" including reporting collateral performance (in terms of, inter alia, delinquencies and repossessions) to Bond investors on Dynex's website.

10. In point of fact, all of Dynex's representations in the Offering Documents and during the Class Period regarding the mobile home loan collateral and Dynex's role as Master Servicer were materially false and misleading. Specifically, in underwriting and originating the mobile home loan collateral, Dynex systematically disregarded "borrower creditworthiness" (¶¶ 56-62). Dynex salespeople were directed to tell mobile home dealers -- as a selling technique to gain business from established competitors like Green Point and Green Tree-- that Dynex would purchase their far from creditworthy paper in order to get the dealer's mobile home loan business (¶¶ 56-60). Further, while underwriting standards existed, officers reporting to Potts and regional officers systematically waived "underwriting and borrower creditworthiness standards" (e.g., permitting loans to borrowers with FICO credit scores below 530) in order to amass the requisite mobile home loan volume to consummate the Bond offerings (¶ 56). Thus, it was not uncommon for corporate officers and regional managers to approve uncreditworthy borrowers whose loan application had already been rejected by field office or lower level underwriters (¶ 60). Dynex also directed its employees to understate reported delinquencies to be below 2% through the end of 1999. (¶ 64). Dynex's undisclosed reckless underwriting and origination

practices resulted in 65% - 70% of its mobile home loan portfolios with undisclosed "Buy For" loans where the mobile home owner and the occupant was not the same as the "borrower" (¶¶ 61-62). Buy For loans rendered the loan application facially defective since, inter alia, the application required an affirmation that the Borrower would be the principal occupant. These undisclosed Buy For loans also had significantly high delinquencies and high permanent default and repossession rates since the typical reason the occupant did not sign the loan application was because the occupant had no viable credit standing and because Federal lending statutes Fair Debt Collection Practice Act, 15 U.S.C. 1692(c) (Sept. 30, 1996), prohibited communication with an occupant who was not the borrower concerning the loan. Dynex also recklessly disregarded "red flags" of uncreditworthy paper by repeatedly purchasing loans from mobile home dealers known to regularly submit falsified loan applications (i.e., doctoring W-2 forms to indicate a higher gross income; a more pronounced employment history; or a different social security number).

11. Further, by 2000 Dynex had ample evidence from its collections operations of massive "First Payment Defaults" where the borrower refused to make even the first payment under the loan as a result of alleged misrepresentations in the sale of the mobile homes (¶ 63). These First Payment Defaults typically reflected predatory lending practices by the mobile home dealers who had promised a fully functional mobile home which when delivered was materially deficient or defective. Given the reasons for the First Payment Defaults, these delinquencies also had a dramatically higher risk of permanent default and repossession. Dynex, in originating these loans, also failed to obtain waivers from the mobile home landowners which ultimately

precluded entirely or substantially Dynex's ability to collect in repossession because Dynex could not enter upon the land where the mobile home was located.

12. Dynex thus knew, or recklessly disregarded, at or about the commencement of the Class Period in February 2000, these material defects and deficiencies in the underwriting and origination of the Bond collateral which undermined the quality of the Bond collateral itself.

13. As a result of these undisclosed defects and deficiencies, Dynex knew, or recklessly disregarded, from the outset of the Class Period both that the Bond collateral would perform poorly (i.e., experience dramatically higher delinquency rates (well above the 1.3% described in the Offering Documents) and "loss severities" – i.e., losses from the inability to recover from repossessions) and that this poor performance would be sustained over time since it would not be due solely to "market conditions," but to the underlying impaired quality of the collateral itself. It was thus materially false and misleading for Dynex to attribute throughout the Class Period the high delinquency, default and loss severity rates with respect to the mobile home loan collateral to the "depressed housing market" (¶ 84); the "saturation of the market with repossessed homes" (¶¶ 84, 86, 87, 94, 100, 110); or the "exit of large lenders" (¶ 92). It was also materially false and misleading to state that it was only as a result of "recent performance" (¶ 100) and delinquency "data" (¶ 100, 110) that Dynex expanded its provision for losses on the mobile home loan collateral to include "all loans greater than 30 days delinquent' and then "current" mobile home loans. In fact, the high delinquencies and loss severities were due to factors known to defendants from the outset of the Class Period and stemmed fundamentally from Dynex's own reckless underwriting and origination practices. The reported loan loss

provisions had thus been materially understated during the Class Period when greater than 30 day delinquent and "current" loans had not been included (¶¶ 100, 110). By early 2004, after years of poor performance, the true condition of the Bond collateral began to be revealed in substantial downgrades by rating agencies. On February 24, 2004, Moody's completed the "review" initiated in September 2003 and dramatically downgraded the Series 13 Bonds from "very high" and "high" credit quality to "probable" and "imminent default." On May 13, 2004, Moody's also similarly downgraded the Series 12 Bonds. These downgrades reflecting to true quality of bond collateral -- which Defendants knew of and recklessly disregarded from the outset of the Class Period -- resulted in dramatic Bond price declines as follows:

MESC 12									
Certificate	**Class**	**Rating at Issuance (Moody's/Fitch)**	**3/10/2004**	**Fitch Downgrade 3/10/2004**	**3/12/2004**	**% Decline**	**Moody's Downgrade 5/13/2004**	**5/17/2004**	**Total % Decline**
MESC 12	1M1	Aa2/AA "very high credit quality"	$ 100.22	A "high credit quality"	$ 100.16	0%	Ca "default probable"	$ 75.56	-18%
	1M2	A2/A "high credit quality"	$ 100.22	BBB- "low investment grade"	$ 92.00	-8%	C "imminent default"	$ 52.44	-33%
	1B	BBB "low investment grade"	$ 100.13	BB- "speculative"	$ 89.66	-10%	C "imminent default"	$ 23.25	-72%

MESC 13						
Certificate	**Class**	**Rating at Issuance (Moody's/Fitch)**	**Price on 2/24/04**	**Rating Downgrade 2/24/04**	**Next Trade (Trade Date)**	**% Decline**
MESC 13					**5/11/2004**	
	M1	Aa2/AA "very high credit quality"	$ 101.875	Ca "default probable"	$ 81.09	20%
	M2	A2/A "high credit quality"	$ 94.625	C "imminent default"	$ 49.94	42%
					11/30/2004	
	B1		$ 102.40		$ 15.38	85%

14. These downgrades and price declines were further fueled by Dynex's disclosures, only beginning in or about September 2003, that it had dramatically understated – by as much as

34% -- reported repossessions and foreclosures of bond collateral (¶¶102, 103, 104) and that in April 2004 Merit had to restate its prior financial results due to "internal control deficiencies" with regard to recording loan loss allowances (¶ 112). These same disclosures also revealed Dynex's failures to act as Master Servicer in reporting the performance of the Bond collateral.

SOURCES FOR FRAUD ALLEGATIONS

15. The sources for the allegations regarding Dynex's recklessness and fraudulent practices were derived from the investigation of counsel, which included interviews with: i) former Dynex employees who worked at Dynex's centralized collection center Forth Worth, Texas during the Class Period and/or during the time beginning under the tenure of John Whitehead. These former employees worked for years in the areas of collection and repossession and, as a result, reviewed delinquent loan files and thus had firsthand knowledge the massive quantity of "Buy For" loans Dynex had originated; ii) that the borrower's lack of creditworthiness was known at the time the loan was originated and that by 2000 Dynex knew, or recklessly disregarded, massive First Payment Defaults raising a red flag to dubious or fraudulent underlying mobile home sales; iii) former Dynex employees who worked in regional sales offices engaged primarily in the origination and underwriting of mobile home loans and thus, had personal knowledge of selling techniques Dynex salespeople were encouraged to use with mobile home loan dealers and internal corporate loan approval procedures and practices; iv) former employees of Dynex's competitors during the Class Period who were familiar with Dynex's sales and/or underwriting practices; and v) other persons with knowledge of the

underwriting and origination practices in the mobile home loan industry during the Class Period and all other relevant periods.

JURISDICTION AND VENUE

16. The federal securities claims asserted herein arise under Sections 10(b) and 20(a) of the Exchange Act of 1934 (15 U.S.C. Sections 78j(b) and 78t(a), Rule 10b-5 promulgated thereunder by the Securities and Exchange Commission (hereafter "SEC") [17 C.F.R. Section 240.10b-5]. The claims arising under Section 10(b) and Rule 10b-5 are based on fraud on the market.

17. This Court has jurisdiction over the subject matter of the federal securities claims pursuant to 28 U.S.C. Sections 1331 and 1337, and Section 27 of the Exchange Act of 1934 [15 U.S.C. Section 78aa].

18. Venue is proper in the Southern District of New York pursuant to Section 27 of the Exchange Act of 1934, and 28 U.S.C. Section 1391(b), given that many of the acts and practices complained of herein occurred in substantial part in this district and principal defendants reside within the district.

19. In connection with the acts and omissions alleged herein, Defendants directly or indirectly used the means and instrumentalities of interstate commerce, including, but not limited to, the mails, interstate telephone communications and the facilities of the national securities markets.

PARTIES

20. Plaintiff, Teamsters Local 445 Freight Divisions Pension Fund, as set forth in the certification annexed hereto, purchased $450,000 par value Merit Series 13 bonds for a total investment of $442,922 during the Class Period. Teamsters 445's principal place of business is located within this Court's jurisdiction in Newburgh, New York.

21. Defendant Merit was incorporated in Virginia on August 19, 1994, a wholly owned limited purpose finance subsidiary of Dynex Capital, Inc. Issuer Holding Corporation, Inc. ("IHC") another wholly owned subsidiary of Dynex, acquired Merit on September 4, 1996. Merit was organized for the purpose of facilitating the securitization of loans through the issuance and sale of collateralized bonds. After the payment of expenses incurred in connection with an offering, Merit would use the net proceeds to purchase collateral, such as mobile home loans, from IHC. From the date of inception through December 31, 1999, Merit issued fourteen (14) series of collateralized bonds, including Series 12 and 13, totaling approximately $10 billion.

22. Defendant Dynex Capital Inc ("Dynex") is a financial services company which invested in a portfolio of securities and investments backed principally by mortgage loans, including manufactured housing installment loans. Dynex's principal place of business is located at 4551 Cox Road, Suite 300, Glen Allen, Virginia.

23. In connection with the Bonds, Dynex was the parent company of Merit, which "issued" the Bonds; Dynex was also parent of IHC, which through one of its subsidiaries originated the Series 12 and Series 13 mobile home loan collateral. Dynex also retained a financial interest in the collateral which secured the Bonds. As a public company, Dynex had to

report in its SEC filings the "impairments" of that investment in terms of loan loss provisions. Dynex's Form 10-K for the year ended December 31, 2001 described Dynex's principal balance of net investment in the Series 13 Bonds as $44.16 million. The reporting of such impairments adversely impacted Dynex's reported profits during the Class Period. Thus, as an "investor" Dynex was disincentivized to accurately report the true adverse performance of the collateral.

24. Fortunately for Dynex, though not for public investors however, Dynex could control the public disclosures regarding the performance of the collateral since it was also "Master Servicer" of the Bonds. (In 1999, Dynex sold its manufactured housing /servicing operation to Origen, however Dynex retained its "Master Servicer function" with respect to the Series 13 collateral to date).

25. As Master Servicer, Dynex purportedly monitored the servicer's compliance with servicing guidelines, monitored and reconciled the loan payments remitted by the servicers of the loans, determined the payments due on the securities, and determined that the funds are correctly sent to a trustee or investor for each series of securities. As Master Servicer, Dynex also provided on its website throughout the Class Period detailed "Monthly Payment Reports" on the collateral it serviced, including the Series 13 Bond Collateral. As Master Servicer, Dynex was paid a monthly fee based on the outstanding principal balance of each such loan serviced by the Company as of the last day of each month. Despite the fact that Dynex erroneously reported the true performance of the bond collateral repossession it continued to receive payment for its Master Service functions.

26. Defendant Merit is a wholly owned limited purpose subsidiary of Dynex. Merit had no physical properties and listed in its public filings the same business address and telephone number as Dynex. In 2003 and 2004, Merit's principal executive officer and director was at all relevant times defendant Stephen J. Bendetti ("Bendetti"). Issuer Holding Corporation ("IHC"), the originator of a substantial portion of the Series 12 and 13 Bond Collateral, was a wholly owned subsidiary of Merit. Merit issued the Series 12 and 13 Bonds and sold them to the Underwriters receiving approximately $605 million in proceeds. Merit also purchased a portion of the Class M2 bonds through an affiliate and then sold these bonds to the investing public during the Class Period.

27. Defendant Benedetti was at all relevant times the President and Chief Executive Officer of Merit. From September 1997 through December 1998, he was Vice President and Controller of Dynex. Benedetti has served as Vice President and Treasurer of the Dynex since October 1997; and from September 1994 until December 1998, Mr. Benedetti served as Vice President and Controller. In May 2000, Mr. Benedetti assumed the responsibilities of Lynn K. Geurin who resigned as Chief Financial Officer and Secretary of the Dynex. Benedetti was also a member of Dynex's Board of Directors. From 2003 through the end of the Class Period, defendant Benedetti was also both the Principal Executive Officer and Chief Financial Officer of Dynex. Benedetti, as a result of his various senior positions, was well aware of the data derived from the collections operations with respect to the Bond collateral both before the Class Period (when Dynex itself serviced the Bond collateral) and during the Class Period (when Dynex acted as Master Servicer with respect to the Bond collateral) which reflected the high percentage of

Buy Fair Loans, First Payment Default delinquencies and failed or impaired repossessions as a result of the failure to obtain requisite releases and as alleged herein waivers. As a result, Benedetti knew, or recklessly disregarded, that the true reason for the poor performance of the Bond collateral was due, in material part, to the manner in which the collateral was originated. Benedetti also knew, or recklessly disregarded, one of the material undisclosed reasons for the sale of Dynex mobile home loan origination business in 1999 included the poor quality of the collateral which had been originated by Dynex.

28. Defendant Thomas H. Potts ("Potts") was at all relevant times a member of Board of Directors of the Company. From 1997 to June 2002, Potts served as Dynex's President and Principal Executive Officer. Potts also had access before and during the Class Period to collection data high percentage of Buy For loans and First Payment Default delinquencies and failed or impaired repossessions due to failure to obtain the requisite releases and waivers as alleged herein. Potts knew, or recklessly disregarded, that he and the senior officers reporting to him at the corporate headquarters were directly involved in the approval of mobile home loans collateral which failed to satisfy internal underwriting standards and guidelines and were approved only in order to be able to consummator meet loan volume quota and/or the offerings as alleged herein. Potts also well knew that a material, but undisclosed reason, for the sale of Dynex's mobile home loan origination operations in 1999 included the poor quality of the mobile home loans originated.

29. Defendants Benedetti and Potts, are collectively referred to herein as the Individual Defendants. Because of the Individual Defendants' positions with the Company, they

had access to the adverse undisclosed information about its underwriting and origination of Bond collateral, the investment quality of the Bonds, the performance of the Bond collateral, the underwriting of the Bonds and caused, allowed and permitted the false and misleading statements in the Registration Statements and Prospectuses and thereafter in public filings, press release and reports.

30. It is appropriate to treat the Individual Defendants as a group for pleading purposes and to presume that the false, misleading and incomplete information conveyed in the Company's public filings, press releases and other publications as alleged herein are the collective actions of the narrowly defined group of defendants identified above. Each of the above officers of the Company, by virtue of their high-level positions with the Company, directly participated in the management of the Company, was directly involved in the day-to-day operations of the Company at the highest levels and was privy to confidential proprietary information concerning the Company and its business, operations, growth, financial statements, and financial condition, as alleged herein. Said defendants were involved in drafting, producing, reviewing and/or disseminating the false and misleading statements and information alleged herein, were aware, or recklessly disregarded, that the false and misleading statements were being issued regarding the Company and the Bonds, and approved or ratified these statements, in violation of the federal securities laws.

31. As officers and controlling persons of a publicly-held company whose debt securities were, and are, registered with the SEC pursuant to the Exchange Act, and governed by the provisions of the federal securities laws, the Individual Defendants each had a duty to

disseminate promptly, accurate and truthful information with respect to the Company's Bonds and Bond collateral, and to correct any previously issued statements that had become materially misleading or untrue, so that the market price of the Company's Bonds would be based upon truthful and accurate information. The Individual Defendants' misrepresentations and omissions during the Class Period violated these specific requirements and obligations.

32. The Individual Defendants participated in the drafting, preparation, and/or approval of the various public and shareholder and investor reports and other communications complained of herein and were aware of, or recklessly disregarded, the misstatements contained therein and omissions there from, and were aware of their materially false and misleading nature. Because of their Board membership and/or executive and managerial positions with Merit and or Dynex, each of the Individual Defendants had access to the adverse undisclosed information about the underwriting practices used to originate the Series 12 and 13 Bond Collateral and the true adverse performance of that collateral during the Class Period as particularized herein and knew (or recklessly disregarded) that these adverse facts rendered the positive representations made by Merit and/or Dynex about the Bonds materially false and misleading.

33. The Individual Defendants, because of their positions of control and authority as officers and/or directors of the Company, were able to and did control the content of the various SEC filings, press releases and other public statements pertaining to the Bonds during the Class Period. Each Individual Defendant was provided with copies of the documents alleged herein to be misleading prior to or shortly after their issuance and/or had the ability and/or opportunity to prevent their issuance or cause them to be corrected. Accordingly, each of the Individual

Defendants are responsible for the accuracy of the public reports and releases detailed herein and are therefore primarily liable for the representations contained therein.

34. Each of the defendants is liable as a participant in a fraudulent scheme and course of business that operated as a fraud or deceit on purchasers of the Bonds by disseminating materially false and misleading statements and/or concealing material adverse facts. The scheme: (i) deceived the investing public regarding the underwriting practices used to originate the Bond Collateral, including manufactured housing loans and the performance of that collateral during the Class Period; and (ii) caused plaintiff and other members of the Class to purchase the Bonds at artificially inflated prices.

PLAINTIFF'S CLASS ACTION ALLEGATIONS

35. Plaintiff brings this action as a class action pursuant to Federal Rule of Civil Procedure 23(a) and (b)(3) on behalf of a Class, consisting of all those who purchased the Merit Series 12 and Series 13 Bonds in the open market purchasers of the Series 12 and 13 Bonds between February 7, 2000 and May 13, 2004, inclusive (the "Class Period") and who were damaged thereby. Excluded from the Class are defendants, the officers and directors of the Company, at all relevant times, members of their immediate families and their legal representatives, heirs, successors or assigns and any entity in which defendants have or had a controlling interest. The collateral for the Bonds was composed of entirely mobile home loans and was originated by Dynex between 1997 and 1999. The prices of the Bonds were artificially inflated by the identical materially false and misleading descriptions of the underwriting and origination of the mobile home loan collateral contained in the Merit Offering Documents; and

by Dynex and Merit's subsequent false and misleading statements regarding the Bond collateral as set forth below.

36. The Bonds also all shared the same fundamental structure. As noted, each Series was divided into a hierarchy of classes (e.g., A-1, A-2, A-3, A-4, M-1, M-2, B-1). Each class was assigned a specific amount of collateral by term. The A-1 class, for example, had to mobile home loans of shorter durations and the Bonds would be fully repaid within a shorter duration than all other classes within that series. It was for that reason that the higher classes were deemed to have less risk. This "class structure" also provided that the payment of principal and interest to the senior classes (e.g., A-1 and A-2) occurred before the subordinate classes (e.g., A-3, A-4, . . . M-2).

37. Under the terms of the Bonds as set forth in the prospectus, bondholders were to be paid monthly interest and principal from payments from principal and interest payments made by the borrowers under the manufactured housing contracts. Merit and Dynex would incur "losses" on the collateral if there were defaults on payments under the loan agreement such that subsequent foreclosures upon the mobile home yielded less than the loan amount. Such losses were borne by Merit (and Dynex) only to the extent that the collateral value exceeded the bond balance and thereafter by the bonds in reverse order of seniority.

38. On each payment date the holders of the higher ranking classes of bonds had preferential rights to receive payment. Payment of interest and principal from manufactured home contracts were paid first to the higher class of bonds before payment was made to any subordinate class.

39. Classes M would not receive any principal until the senior classes had been reduced to zero. Class B would not receive any principal until the senior and classes M principal had been reduced to zero.

40. In addition, the issuer agreed to an "overcollateralization" commitment which in each Series was approximately 3% to 5% of the loan balance. If the overcollateralization amount as exhausted due to, for example, losses on the mobile home loans in repossessions, the issuer could provide supplemental support for the Bonds through loans and lines of credit. However, Merit had no obligation to make any further deposits to the collateralization fund. The interest on the collateralization fund was to be drawn upon to the extent available if funds from the interest on the underlying collateral was insufficient to pay the interest and principal due on the Bonds.

41. All purchasers of Bonds relied on the identical false statements describing the underwriting and origination of the collateral as set forth herein (e.g., ¶¶ 67-70).

42. The Bonds trading prices reacted efficiently to market information (¶¶ 108, 113).

43. The Company and the Bonds were followed closely by securities and manufactured housing industry analysts, as well as credit rating agencies (including Fitch and Moody's) (¶¶ 72, 105, 107, 109, 113).

44. A liquid market for the Bonds existed at all times during the Class Period. There were approximately at least twelve broker-dealers (including Lehman Brothers, Inc. and Credit Suisse First Boston) that made a market for the Bonds. On any given trading day, approximately

four or more broker-dealers would post a bid and ask quote for the Bonds, creating an available market for investors to transact in the Certificates (¶¶ 108, 113).

45. The members of the Class are so numerous that joinder of all members is impracticable. While the exact number of Class members is unknown to plaintiff at this time and can only be ascertained through appropriate discovery, plaintiff believes that there are hundreds or thousands of members in the proposed Class. Record owners and other members of the Class may be identified from records maintained by Merit or its transfer agent and may be notified of the pendency of this action by mail, using the form of notice similar to that customarily used in securities class actions.

46. Plaintiff’s claims are typical of the claims of the members of the Class as all members of the Class are similarly affected by defendants' wrongful conduct in violation of federal law that is complained of herein.

47. Plaintiff will fairly and adequately protect the interests of the members of the Class and have retained counsel competent and experienced in class and securities litigation.

48. Common questions of law and fact exist as to all members of the Class and predominate over any questions solely affecting individual members of the Class. Among the questions of law and fact common to the Class are:

(a) Whether the federal securities laws were violated by defendants' acts as alleged herein;

(b) Whether defendants participated in and pursued the common course of conduct complained of herein;

(c) Whether documents filed with the SEC and other documents, press releases and statements disseminated to the investing public and Merit's bondholders during the Class Period misrepresented material facts about the Bonds and the collateral securing the Bonds;

(d) Whether the market price of Merit’s Series 12 and Series 13 Bonds during the Class Period was artificially inflated due to the material misrepresentations and failure to correct the material misrepresentations complained of herein; and

(e) To what extent the members of the Class have sustained damages and the proper measure of damages.

49. A class action is superior to all other available methods for the fair and efficient adjudication of this controversy since joinder of all members is impracticable. Furthermore, as the damages suffered by individual Class members may be relatively small, the expense and burden of individual litigation make it impossible for members of the Class to individually redress the wrongs done to them. There will be no difficulty in the management of this action as a class action.

50. Plaintiff will rely, in part, upon the presumption of reliance established by the fraud-on-the-market doctrine in that:

a) defendants made public misrepresentations or failed to disclose material facts during the Class Period;

b) the omissions and misrepresentations were material;

c) the Bonds traded in an efficient market;

d) the misrepresentations and omissions alleged would tend to induce a reasonable investor to misjudge the value of the Bonds; and

e) Plaintiff and members of the Class purchased the Bonds between the time the defendants failed to disclose or misrepresented material facts and the time the true facts were disclosed, without knowledge of the omitted or misrepresented facts.

51. Based upon the following, plaintiff and members of the Class are entitled to the presumption of reliance upon the integrity of the market.

52. In addition, plaintiff will rely, in part, upon the presumption of reliance established by the fraud-created-the-market doctrine in that: had the defendants' common scheme and plan to fraudulently originate and service manufactured housing mortgage loans, for the purpose of providing the collateral for the Bonds, been fully disclosed to investors the Bonds could not have been marketed.

SUBSTANTIVE ALLEGATIONS

53. Dynex Capital was a financial services company, which through its subsidiaries, including Merit, issued and invested in securities backed by mortgages including single family home loans, commercial mortgages and manufactured housing (or mobile homes) installment loans. Up until the end of 1999, Dynex through its subsidiaries originated the mobile home loans it then pooled and pledged as collateral for the non-recourse bonds it issued to investors. Typically, a volume of loans had to accumulate to at least $320 million before they could be pooled for securitization. In 1999, Dynex, through Merit, conducted two bond offerings collateralized entirely with mobile home loans.

54. On or about March 29, 1999 and August 31, 1999 Merit issued, pursuant to Prospectus Supplements filed with the SEC, $323,340,000 of the Series 12 Bonds and $341,250,000 of the Series 13 Bonds. The principal collateral for the Series 12 and Series 13 Bonds was $336,967,468 and $303,975,556, respectively, of manufactured housing installment sales contracts.

55. Dynex originated the mobile home loan collateral between 1997 and 1999 through IHC and Dynex Financial Services, Inc. Dynex was a relatively "late comer" to the mobile home loan business. Dynex faced a number of obstacles to entry. By 1996 the mobile home loan market was dominated by long time mobile home loan origination companies such as Green Tree Financial Services Inc. ("Green Tree") and Green Point, Inc ("Green Point"). These dominant companies had national physical presence with offices throughout the United States with established relationships with mobile home dealers. The only way a "new comer," such as Dynex, could obtain volume home loans in areas predominated by these companies was to take the mobile home loan dealers' "bad paper." Fraudulent mobile home loan applications were prevalent and widely known during this period driven by oversupply of mobile home product. Mobile home dealers were known to submit on behalf of a prospective purchaser loan applications which contained false information as to the prospective purchaser's credit, employment, income and assets. However, the mobile home dealers were well aware that mobile home loan origination companies, particularly "new companies" such as Dynex, were desperate to amass a large volume of mobile home loans in order to take advantage of the "hot" mortgage-backed securities market, and thus could be expected to purchase loans made to uncreditworthy borrower. Dynex, of course, marketed to the mobile dealers' "weakness."

Dynex Sales People Directed to Tell Mobile Home Dealers That Dynex Would "Buy Deep"

56. Dynex Financial, during the period 1997 through 1999, set up field offices throughout the country with regional headquarters in Charlotte, North Carolina; Atlanta, Georgia; Cincinnati, Ohio; and Dallas, Texas. The largest source of mobile home loan collateral was Texas. The regions generated between $60 and $90 million annually. In each region there was a regional Vice President and in each branch or field office there were branch managers. The branch managers and Vice Presidents had the power to waive underwriting guidelines for loans up to $85,000. Loans in excess of $85,000 were approved by Dynex's corporate headquarters. The sales force was directed to tell mobile home dealers that Dynex was willing to "buy deep" – meaning Dynex would purchase the dealer's less than creditworthy loans if Dynex would be able to purchase the other "good paper." Dynex thus knowingly purchased bad loans from the outset since that was the means to enter a highly competitive market. Bad loans consisted of applicants who either had no credit or had bad credit. Bad credit included a FICO score under 550; unstable employment history; history of unpaid accounts and bills. Dynex also paid mobile home dealers between 1.5% and 3% of the loan to obtain the loan business.

57. The FICO system is a scoring system that converts over 30 different variables of an individual's credit profile into a number score. The most important variables include mortgage history, derogatory credit history, liens or judgments, length of credit history, depth of credit history, proportion of debt to credit balances and amounts of available credit. The approximate credit score correlates to grades as follows:

Credit Score Correlated to Letter Grades

720 and up: AA
700 to 719: A
680 to 699: A/B+
660 to 679: B+/B

640 to 659: B
620 to 639: B-/C+/C
600 to 619: C/D
580 to 599: D/F
579 and below: F

(Source: AtVantage.Com).

58. Freddie Mac, for example, provides that unless there are extenuating circumstances a credit score less than 620 "should be viewed as a strong indication that the borrower does not have an acceptable credit reputation." See Freddie Mac, Determining Underwriting Scores and Indicator Scores (August 2004).

59. The internal corporate culture of Dynex was also completely focused on achieving high loan volume. The Company set monthly quotas from the highest levels to the field offices. Management and employee compensation derived from meeting quotas constituted a substantial portion of total annual compensation. Many regions, particularly the Texas region, led by Regional Vice President, John Whitehead, "miraculously" achieved enormous loan volume quotas on the last few days of each quarter.

60. The Company established underwriting guidelines, but then gave the branch managers and regional managers, such as John Whitehead, Walter McGee, Brad Nole, and Greg Usher, wide latitude to waive those guidelines. Such waivers were reportedly used to achieve the volume loan quota. Indeed, mobile dealers would often circumvent the underwriters and go directly to branch and regional Vice Presidents to have the underwriting guidelines waived or have the guidelines waived by senior management after it was rejected by lower level underwriters following the guidelines. This was achieved by agreeing to purchase "bad paper" – where there was no requisite documentation of borrower employment income or assets or with

facially fraudulent documentation of the same; the borrower was a minor, elderly or deceased; the borrower was not to be the occupant and so the loan was a "Buy For" loan.

Dynex Mobile Home Loans Significantly Impaired With Uncollectible "Buy-For" Loans

61. By 2000, Dynex knew approximately 65% - 70% of the delinquent mobile home loans were "Buy For" loans. These loans were inherently uncreditworthy and had little prospect for collection and high likelihood for repossession for several reasons. Buy For loans were loans were the actual occupant of the mobile home had no viable credit standing, and thus, could not even submit a loan application. A more creditworthy relative or friend would fill out the loan application, even though that person did not sign the contract for the mobile home. Indeed, in many instances the borrower on the Buy For loan application was an elderly person (i.e., in their late seventies or senior) who was approved for mobile home loan with a thirty year term, and in some instances even deceased. In addition, Dynex was aware of "red flags" with regard to uncreditworthy loans since it repeatedly purchased loans for mobile home dealers who were known to regularly submit falsified loan applications (i.e., doctoring W-2 forms to indicate higher gross income; a more pronounced employment history; or a different social security number).

62. Dynex knew, or recklessly disregarded, that it bought Buy For loans because the Dynex loan files contained both the loan application and the mobile home contract, and thus, it was apparent in the case of a Buy For loan the name and signature on the loan application was different from the name and signature on the mobile home contract. Dynex also knew of its Buy For loans because collectors at its Texas offices reported this condition. The Buy For loan became largely uncollectible because when the occupant of the mobile home was contacted by

telephone or by an in-person visit that they were delinquent on their payments they would disregarded Dynex stating that they did not sign any loan agreement with Dynex. Further, the loan application became defective on its face since it stated the signatory would be the occupant and that was false for a Buy For loan. In addition, not only was the signatory on the loan application reluctant to make payments for the delinquent occupant and payor, but the Dynex collectors were forbidden by the Fair Debt Collection Practice Act, 15 U.S.C. 1692(c) (Sept. 30, 1996), to even contact the occupant without the permission of the person who signed the loan application. This created yet another known but undisclosed material impediment to any expectation of collateral.

Dynex Loans Significantly Impaired By "First Payment Default" Deficiencies

63. By 1999, Dynex collectors also saw significant "First Payment Defaults." These were loans which became delinquent in the very first month because the mobile home loan dealer failed to either provide the mobile home contracted or represented it would provide the buyer; the mobile home was defective in terms of functionally (including functionality of appliances or other facilities); or the mobile home was improperly situated on the property as the dealer had represented. The underwriters at the regional sales offices knew that a majority of the manufactured home dealers were selling inferior product and practiced shoddy workmanship in the installing process. Despite internal "red flags" on applications send to Dynex by these non-reputable dealers, the underwriters knowingly approved the loan where a first payment default was eminent. By 1999, it was also overwhelmingly clear to Dynex that these deficiencies were generally not corrected and the property would ultimately default into foreclosure and repossession.

Dynex Collectors Were Directed to Falsify Reported Delinquency
Percentages To Keep Under 2% of Outstanding Loan Balance

64. By 1999, Dynex had been for over two years pressuring its collectors to limit delinquencies (in any form: 30 days, 60 days, 90 days or repossession) to less than two percent (2%) of the outstanding mobile home loan balance. By the end of 1998, this was becoming impossible due to increased delinquencies. Dynex thus directed that the reported delinquencies be falsified. Indeed, the delinquency percentage reported in the Series 12 and Series 13 Offering Documents were 1.68% and 1.36%, respectively. (See Series 12 Prospectus at p. 31 of 151[1]; Series 13 Prospectus at p. S-17).

Dynex's Additional Undisclosed Reckless Business
Practices In The Origination of Collateral

65. In addition to the above improper underwriting practices, Dynex engaged in other practices, which were so reckless that they largely doomed any hope of collection from foreclosure in the event of delinquency – or in other words ensured astronomically high "loss severities" (losses from foreclosure and repossession). Dynex failed to obtain releases from the land owner who owned the property where the mobile home was placed. The effect of this failure was to preclude Dynex from entering into the property to reclaim the mobile home or to have to negotiate with the landowner -- who was also typically owed money by the defaulting borrower -- to get only a portion of the asset value upon resale. The failure to obtain the release from the landowner thus had the effect of either precluding Dynex from repossessing the mobile home at all or at best obtaining only a portion of the proceeds from repossession with the balance going to the landowner who was typically owed rent monies from the mobile homeowner.

[1] Many of Dynex's and Merit's filings with the SEC do not contain internal page numbering. Therefore, in order to provide the Court with the precise location of the alleged false and misleading statement, whenever a filing was devoid of internal page numbering we referenced the specific page using the page numbering provided by www.SECInfo.com, a free website which publishes SEC filings.

66. Finally, Dynex also failed to obtain waivers from litigating in Native American courts when a mobile home was sold to occupants of Native American land. This origination failure again also reduced the likelihood of recovery from repossessions -- thereby increasing future "loss severities" -- in these geographic areas.

DYNEX'S FALSE AND MISLEADING STATEMENTS

Offering Document Statements

67. The Offering Documents stated that a manufactured home loan was typically made based upon a determination of the "Borrower's ability to make monthly payments" and upon an "investment analysis of the related manufactured home to determine the permissible loan size," as follows:

> Under the underwriting standards applicable to the Manufactured Home Loans, the primary considerations in underwriting a Manufactured Home Loan other than the <u>creditworthiness of the Borrower</u>, are the results of an investment analysis of the Manufactured Home, which is used to determine the allowable Loan size, and the adequacy of such property as collateral in relation to <u>the amount of the Manufactured Home Loan</u>.
>
> * * *
>
> CONSUMER FINANCE LOANS. A Consumer Finance loan typically is made based upon a determination <u>of the Borrower's ability to make Monthly Payments</u> on the Consumer Finance Loan and upon the purchase price of the related Facilities and the costs of installing the Facilities in a single family residential property.

(Series 12 Prospectus at p. 62 of 151; Series 13 Prospectus at p. 9) (Emphasis added).

68. Specifically, the loan origination was to follow either Fannie Mae or Federal Home Loan Mortgage Corporation ("FHLMC") standards on IHC's credit appraisal and underwriting standards and guidelines or the "Participant's" guidelines. The purpose of both was purportedly to evaluate each prospective borrower's credit standing:

> Each Manufactured Home Loan will be originated by the Participant or acquired by the Participant from the originator. In originating a Mortgage Loan or a

Manufactured Home Loan, the loan originator (the *"Originator"*) will follow either (a) its own credit approval process, to the extent that such process conforms to underwriting standards generally acceptable to Fannie Mae or FHLMC, or (b) the Participant's various credit, appraisal and underwriting standards and guidelines.

Both the Fannie Mae and FHLMC underwriting standards and the Participant's underwriting standards are applied in a manner intended to comply with applicable federal and state laws and regulations**. The purpose of applying these standards is to evaluate each prospective Borrower's credit standing and repayment ability and the value and adequacy of the related Mortgaged Premises as collateral.** The mortgage loans and manufactured housing installment sales contracts originated under the Participant's underwriting standards generally are based on loan application packages submitted by mortgage brokerage companies, manufactured home dealers or consumers for underwriting review, approval and funding by the Participant or an Affiliate of the Participant.

(Series 12 Prospectus at p. 89 of 151; Series 13 Prospectus at p. 34) (Emphasis added).

69. The underwriting purportedly included obtaining credit data from the borrower and analyzing that data as follows:

In general, a prospective Borrower is required to complete a detailed application designed to provide pertinent credit information. The prospective Borrower generally is required to provide a statement of income as well as an authorization for a credit report that summarizes the Borrower's credit history with merchants and lenders as well as any suits, judgments or bankruptcies that are of public record. The Borrower may also be required to authorize verification of deposits at financial institutions where the Borrower has demand or savings accounts.

In determining the adequacy of the collateral for a Mortgage Loan, an appraisal is made of each Mortgaged Premises considered for financing by a qualified independent appraiser approved by Fannie Mae, FHLMC, the Participant or an Affiliate of the Participant. The appraiser is required to inspect the property and verify that it is in good repair and that construction, if new, has been completed. The appraisal is based on the market value of comparable homes and, if considered applicable by the appraiser, the estimated rental income of the property and a replacement cost analysis based on the current cost of constructing a similar home. All appraisals are required to conform to Fannie Mae or FHLMC appraisal standards then in effect.

In assessing a possible Manufactured Home Loan, the Participant determines the amount that it is willing to lend based not on an appraisal but on an investment

analysis based on the invoice price of the Manufactured Home plus accessories, freight, taxes, insurance and other costs. The use of an investment analysis in the underwriting of manufactured housing installment sales contracts is customary in the financing of manufacturing housing. If the Manufactured Home Loan is also to be secured by Real Property, the Participant may have the Real Property appraised in the same manner as Mortgaged Premises are appraised.

Once all applicable employment, credit and property information is received, a determination generally is made as to whether the prospective Borrower has sufficient monthly income available (i) to meet the Borrower's monthly obligations on the proposed mortgage loan or contract (generally determined on the basis of the monthly payments due in the year of origination) and other expenses related to the Mortgaged Premises or Manufactured Home (such as property tax and hazard insurance) and (ii) to meet monthly housing expenses and other financial obligations and monthly living expenses. The underwriting standards applied, particularly with respect to the level of income and debt disclosure on the application and verification, may be varied in appropriate cases where factors such as low loan-to-value ratios or other favorable compensating factors exist.

(Series 12 Prospectus at p. 90 of 151; Series 13 Prospectus, p. 35) (Emphasis added).

70. The Offering documents further provided that high loan-to-value ration loans required a further "full documentation analysis" while lower loan-to-value ration loans could be subjected to a "limited documentation program" as follows:

A prospective Borrower applying for a loan pursuant to the full documentation program is required to provide, in addition to the above, a statement of income, expenses and liabilities (existing or prior). An employment verification is obtained from an independent source (typically the prospective Borrower's employer), which verification generally reports the length of employment with that organization, the prospective Borrower's current salary and whether it is expected that the prospective Borrower will continue such employment in the future. If a prospective Borrower is self-employed, the Borrower may be required to submit copies of signed tax returns. For other than self-employed Borrowers, income verification may be accomplished by W-2 forms or pay stubs that indicate year to date earnings.

Under the limited documentation program, emphasis is placed both on the value and adequacy of the Mortgaged Premises or Manufactured Home as collateral and on credit underwriting, although certain credit underwriting documentation concerning income and employment verification is waived. The maximum permitted loan-to-value ratios for loans originated under such program are

generally lower than those permitted for similar loans originated pursuant to the full documentation program.

(Series 12 Prospectus at id.; Series 13 Prospectus at id.) (Emphasis added).

71. The statements contained in paragraphs 66 through 69 were materially false and misleading because the creditworthiness of the borrower as well as deficiencies in borrower documentation was systematically disregarded by Dynex regional and corporate officers in order to reach loan volume quotas and/or loan volume amounts necessary to consummate the Bond Offerings. The sources for these allegations are contained in paragraphs 15, 56, 60, 61 and 62, supra.

72. The above misrepresentations and omissions concerning the mobile home loan underwriting and origination of the Bonds resulted, in material part, in "high quality" credit ratings by ratings agencies, such as Fitch and Moody's as follows:

Series	Class	Principal Amount	Coupon	Fitch Rating	Moody's Rating
12	A1	$73,650,000	6.16%	Aaa	AAA
	A2	$42,500,000	6.19%	Aaa	AAA
	A3	$132,523,000	6.95%	Aaa	AAA
	M1	$32,000,000	7.63%	Aa2	AA
	M2	$24,889,000	8.35%	A2	A
13	A1	$75,000,000	7.04%	Aaa	AAA
	A2	$35,000,000	7.39%	Aaa	AAA
	A3	$47,000,000	7.63%	Aaa	AAA
	A4	$116,000,000	7.88%	Aaa	AAA
	M1	$41,364,000	7.88%	Aa2	AA
	M2	$26,886,000	7.88%	A2	A

These superlative credit ratings, as well as the alleged misrepresentations during the Class Period alleged herein, in turn caused, in material part, the Bonds to trade at par or above during a substantial portion of the Class Period through early 2004.

False and Misleading Statements During the Class Period

73. During the Class Period defendants' made disclosures concerning the Bonds and its collateral through three sources of information: Dynex Capital's SEC filings; Merit's SEC filings; and the monthly reports on the performance of the Bond collateral reported on Dynex website. The disclosures from each of these sources were materially false and misleading.

74. On or about April 18, 2000, Dynex Capital filed it s Form 10-K for the year ended December 31, 1999. The Form 10-K touted under the heading "Prior Lending Operations" that its was a "vertically integrated lender" that utilized "internally generated guidelines" to originated loans and then listed mobile home loans production in 1997, 1998 and 1999 as follows:

> The Company generally has been a vertically integrated lender by performing the sourcing, underwriting, funding and servicing of loans to maximize efficiency and provide superior customer service. The Company generally has focused on loan products that maximize the advantages of the REIT tax election and has emphasized direct relationships with the borrower and minimized, to the extent practical, the use of origination intermediaries. **The Company has historically utilized internally generated guidelines to underwrite loans for all product types and maintained centralized loan pricing, and performed the servicing function for loans on which the Company has credit exposure.**

Dynex Capital Form 10-K for year ended Dec. 31, 1999, p. 4 (Emphasis added).

75. The statements set forth in the preceding paragraph were materially false and misleading because Dynex's senior management systematically disregarded the underwriting guidelines to achieve loan volume and Dynex recklessly disregarded its servicing duties as Master Servicer with respect to the loan collateral. The sources for these allegations are contained in paragraphs 15, 56, 60, 61, 62, supra, and 102 and 112, infra.

76. Defendant Potts signed a Letter to Shareholders dated April 28, 2000 which gave an "explanation" for its sale of the mobile home loan business that based the decision entirely on "market" factors failing to disclose that the defective quality of its mobile home loans was due to its reckless underwriting practices:

> As a result of that environment, it became apparent in the second quarter of 1999 that our production activities were not going to be economic – it is difficult to make money as a lender without a competitive source of funding. Our sources of funding , be it interim lenders such as commercial banks and Wall Street firms, or long term investors in our securitization were generally changing specialty finance companies, including Dynex, higher rates or were unwilling to renew credit lines under reasonable terms. **This led to our decision to sell** during 1999 our model home purchase/leaseback business ("Dynex Residential, Inc." or "DRI") and **our manufactured housing lending business** ("Dynex Financial, Inc." or "DFI").

Dynex 1999 Annual Report, p. 1. (Emphasis added.)

77. The statements contained in the preceding were materially false and misleading because Dynex failed to disclose that a material factor in the decision to sell the mobile home loan lending business was the poor underwriting and origination practices engaged in which produced materially defective mobile home loan portfolios.

78. Dynex monitored the performance of the Bond collateral because it had the potential to directly impact Dynex's reported profits. Dynex's earning were derived largely from the payments received from its mortgage portfolio (net of payments to bondholders) however, these earnings would have to be offset by increased loan loss reserves. Thus, in its SEC filings Dynex purported to monitor risk of default on borrowers on collateral and purportedly established reserves based on this risk. However, the description of risk was materially false and misleading because again it referred only to "potential market conditions" and the reserves were materially understated as follows:

> Credit Risk. Credit risk is the risk of loss to the Company from the failure by a borrower (or the proceeds from the liquidation of the underlying collateral) to fully repay the principal balance and interest due on a loan. A borrower's ability to repay, or the value of the underlying collateral, could be negatively influenced by economic and market conditions. These conditions could be global, national, regional or local in nature. When a loan is funded and becomes part of the Company's investment portfolio, the Company has all of the credit risk on the loan should it default. Upon securitization of the pool of loans, the credit risk retained by the Company is generally limited to the net investment in collateralized bonds and subordinated securities. The Company provides for reserves for expected losses based on the current performance of the respective pool of loans; however, if losses are experienced more rapidly due to market conditions than the Company has provided for in its reserves, the Company may be required to provide for additional reserves for these losses.
>
> The Company began to retain a portion of the credit risk on securitized mortgage loans in 1994 as mortgage pool insurance became less available in the market and as the Company diversified into other products. The Company evaluates and monitors its exposure to credit losses and has established reserves and discounts for probable credit losses based upon anticipated future losses on the loans, general economic conditions and historical trends in the portfolio.

Dynex 1999 Form 10-K p.7 (Emphasis added).

79. The statements contained in the preceding paragraph were materially false and misleading because Dynex was materially understating it loan loss provision by failing to include reasonably anticipated losses from “over 30 days delinquent” and “current” mobile home loan collateral which was known given the high percentage of First Payment Default delinquencies experienced to date and the high percentage of delinquent Buy For loans. The sources for these allegations are contained in paragraphs 15, 63, 64, 65, 66, supra, and 100 and 110, infra.

80. Dynex also falsely reported its “masters servicers function” with respect to the Bond collateral:

> The Company performs the function of master servicer for certain of the securities it has issued. The master servicer's function typically includes monitoring and reconciling the loan payments remitted by the servicers of the loans, determining the payments due on the securities and determining that the funds are correctly sent to a trustee or investors for each series of securities.

Master servicing responsibilities also include monitoring the servicers' compliance with its servicing guidelines. As master servicer, the Company is paid a monthly fee based on the outstanding principal balance of each such loan master serviced or serviced by the Company as of the last day of each month. As of December 31, 1999, the Company master serviced $3.0 billion in securities.

Dynex 1999 Form 10-K, p. 5 (Emphasis added).

81. The statements contained in the preceding paragraph were contained in Dynex's subsequent Form 10-Ks issued in years 2001 through 2004. Each of these statements were materially false and misleading because Dynex recklessly disregarded its Master Servicer functions and duties as reflected in the disclosure of the material understatement of cumulative repossessions and absence of sufficient internal controls to assess loan loss provisions including with respect to mobile home loan collateral. The sources for these allegations are contained in paragraphs 15, supra, and 102 and 112, infra.

82. The Merit 1999 SEC filing on May 9, 2000 described the limits of its exposure reflected in its "allowance for Losses on Collateral" generally was to the amount of collateral in excess of investment grade bonds issued and that that allowance had actually decreased in 1999 as compared to 1998 to $11.8 million from $16.593 million:

NOTE 4 - ALLOWANCE FOR LOSSES ON COLLATERAL FOR COLLATERALIZED BONDS

The following table summarizes the activity for the allowance for losses on collateral for collateralized bonds for the years 3 ended December 31, 1999,1998 and 1997:

	1999	1998	1997
Beginning balance	$ 16,593	$ 24,811	$ 31,732
Provision for losses	13,555	6,236	2,800
Losses charged-off, net of recoveries	(18,318)	(14,454)	(9,721)
	$ 11,830	$ 16,593	$ 24,811

The Company has limited exposure to credit risk retained on loans which it has securitized through the issuance of collateralized bonds. The aggregate loss exposure is generally limited to the amount of collateral in excess of the related investment-grade collateralized bonds issued

> (commonly referred to as *"overcollateralization"*), excluding price premiums and discounts and hedge gains and losses. The allowance for losses on the overcollateralization totaled $11,830 and $16,593 at December 31, 1999 and 1998 respectively, and is included in collateral for collateralized bonds in the accompanying consolidated balance sheets. Overcollateralization at December 31, 1999 and 1998 totaled $187,070 and $144,359 respectively.

Merit 1999 Form 10-K at p. 17 of 26.

83. The statements contained in the preceding paragraph were materially false and misleading because the 1999 allowance amount was materially understated in that it did not include losses from "current" and "over 30 days delinquent" mobile home loan collateral which was reasonably anticipated to be delinquent due to the reckless underwriting and origination practices and undisclosed high percentage of First Payment Default and Buy For delinquencies. The sources for these allegations are contained in paragraphs 15, 61, 62, 63, supra, and 100 and 110, infra.

84. On May 4, 2001, Dynex reported its 2000 results, which included significantly higher credit losses from "underperformance" of mobile home loans. Defendant Potts Letter to Shareholders dated May 4, 2001 was misleading in that it falsely conveyed surprise in the mobile home loans performance and also attributed the poor performance to market conditions:

> Further, today the Company has *unrealized losses* on its securitized assets of nearly $120 million. These unrealized losses are due in large part to projected credit losses on both the Company's manufactured housing loans and commercial mortgage loans. While credit losses to date on the commercial mortgage loans have been consistent with our expectations, the manufactured housing loans are currently experiencing higher loss severities than previously anticipated due to the depressed state of the manufactured housing section.

Dynex 2000 Annual Report, p. 1-2 (Emphasis added).

85. The statements in the preceding paragraph were materially false and misleading because as known to defendants, but undisclosed, the material cause for the mobile home loan loss severities was the reckless underwriting and origination practices engaged in by defendants

resulting in, inter alia, high percentages of First Payment Defaults and Buy For delinquencies. The sources for these allegations are contained in paragraphs 15, 61, 62, 63, supra.

86. The Form 10-K filed on that same date was similarly misleading describing the more than doubling of the loan loss provision to $34.6 million in 2000 due largely to mobile home loans as a result of market condition as follows:

> Provision for losses increased to $34.6 million in 2000, or 0.93% of average interest earning assets, from $16.1 million or 0.35% during 1999. The provision for losses increased as a result of an overall increase in credit risk retained from securities issued by the Company (principally for securities issued in the latter portion of 1999), and a charge of $13.3 million in the fourth quarter of 2000 due to the underperformance of the Company's securitized manufactured housing loan portfolio. **The Company has seen the loss severity on manufactured housing loans increase dramatically since the end of the third quarter of 2000 as a result of the saturation in the market place with both new and used (repossessed) manufactured housing units. In addition, the Company has seen some increase in overall default rates on its manufactured housing loans.** The Company anticipates that market conditions for manufactured housing loans will remain unfavorable through 2001.

Dynex 2000 Form 10-K at p 22 of 73. (Emphasis added).

87. The statements in the preceding paragraph were materially false and misleading because as known to defendants, but undisclosed, the material cause for the mobile home loan loss severities was the reckless underwriting and origination practices engaged in by defendants resulting in, inter alia, high percentages of First Payment Defaults and Buy For delinquencies. These statements were additionally misleading because the amount of the loan loss provision was materially understated for failing to include "current" and "greater than 30 days delinquent" mobile home loans. The sources for these allegations are contained in paragraphs 15, 61, 62, 63, supra, and 100 and 110, infra.

88. The Merit Form 10-K dated April 16, 2001 contained a similar explanation for the loan loss provisions from $13.6 million in 1999 to $34.1 million in 2000, as follows:

> Provision for losses increased to $34.1 million in 2000 from $13.6 million in 1999 as a result of an overall increase in credit risk retained from securities issued by the Company (principally for securities issued in the latter portion of 1999), and a charge of $13.3 million in the fourth quarter of 2000 due to the underperformance of the Company's securitized manufactured housing loan portfolio. <u>The Company has seen the loss severity on manufactured housing loans increase dramatically since the end of the third quarter of 2000 as a result of the saturation in the market place with both new and used (repossessed) manufactured housing units</u>. In addition, the Company has seen some increase in overall default rates on its manufactured housing loans. The Company anticipates that market conditions for manufactured housing loans will remain unfavorable through 2001. <u>Provision for losses increased to $13.6 million in 1999 from $6.2 million in 1998 primarily due to the addition of three series of collateralized bonds during 1999</u>.

Merit 2000 Form 10-K at p. 7 of 30 (Emphasis added).

89. The statements in the preceding paragraph were materially false and misleading because as known to defendants, but undisclosed, the material cause for the mobile home loan loss severities was the reckless underwriting and origination practices engaged in by defendants resulting in, <u>inter</u> <u>alia</u>, high percentages of First Payment Defaults and Buy For delinquencies. These statements were additionally misleading because the amount of the loan loss provision was materially understated for failing to include "current" and "greater than 30 days delinquent" mobile home loans. The sources for these allegations are contained in paragraphs 15, 61, 62, 63, <u>supra</u>, and 100 and 110, <u>infra</u>.

90. The Merit Form 10-K also described increased reserves for "credit exposure" from the Bond collateral:

> Credit Exposures
> With collateralized bond structures, the Company retains credit risk relative to the amount of overcollateralization required in conjunction with the bond insurance. Losses are generally first applied to the overcollateralized amount, with any losses

> in excess of that amount borne by the bond insurer or the holders of the collateralized bonds. The Company only incurs credit losses to the extent that losses are incurred in the repossession, foreclosure and sale of the underlying collateral. Such losses generally equal the excess of the principal amount outstanding, less any proceeds from mortgage or hazard insurance, over the liquidation value of the collateral. To compensate the Company for retaining this loss exposure, the Company generally receives an excess yield on the collateralized loans relative to the yield on the collateralized bonds. At December 31, 2000, the Company retained $184.7 million in aggregate principal amount of overcollateralization compared to $187.1 million at December 31, 1999. The Company had reserves, or otherwise had provided coverage on $79.1 million and $49.3 million of this potential credit loss exposure at December 31, 2000 and 1999, respectively. At December 31, 2000 and 1999, $30.3 million of these reserve amounts are in the form of a loss reimbursement guarantee from an A rated third-party. During 2000, the Company provided for additional reserves of $34.1 million and incurred credit losses of $25.7 million.

Merit 2000 Form 10-K at p. 8 of 30.

91. The statements contained in the preceding paragraph were materially false and misleading because the amount of the provision for loan loss was materially understated for failing to include "current" mobile home loans and "all loans greater than 30 days delinquent." The sources for these allegations are contained in paragraphs 15, supra, and 100 and 110, infra.

92. On April 8, 2002, Defendant Potts issued another Letter to Shareholders which again falsely attributed continued poor performance of mobile home loans to "market" conditions as follows:

> As referenced above, we are experiencing a high level of credit losses on the manufactured housing loan portfolio. These losses are primarily related to the depressed market for repossessed manufactured homes, compounded by the exit from that market of several large lenders. We will continue to try to minimize these losses; however shareholders' equity already reflects that these credit losses remain high. The remaining exposure of shareholders' equity to the performance of the manufactured housing loan portfolio is quite low.

Merit 2001 Annual Report, p. 1. (Emphasis added).

93. The statements in the preceding paragraph were materially false and misleading because as known to defendants, but undisclosed, the material case for the losses in the mobile home loan portfolio was Dynex's reckless underwriting and origination practices as alleged herein. The sources for these allegations are contained in paragraphs 15, 56, 60, 61, 62, 63, 65, 66, supra.

94. The Merit 2001 Form 10-K filed on May 28, 2002 also attributed the high provision for loan losses due to mobile home loans and particularly to "market conditions":

> Provision for losses increased to $34.5 million in 2001 from $34.1 million in 2000. **The Company has seen the loss severity on manufactured housing loans increase dramatically since the third quarter of 2000 as a result of the saturation in the market place with both new and used (repossessed) manufactured housing units.** In addition, the Company has seen some increase in overall default rates on its manufactured housing loans. The Company anticipates that market conditions for manufactured housing loans will remain unfavorable through 2002. Provision for losses increased to $34.1 million in 2000 from $13.6 million in 1999 as a result of an overall increase in credit risk retained from securities issued by the Company (principally for securities issued in the latter portion of 1999), and a charge of $13.3 million in the fourth quarter of 2000 due to the under-performance of the Company's securitized manufactured housing loan portfolio.

Merit 2001 Form 10-K at p. 9-10 of 34. (Emphasis added).

95. The statements in the preceding paragraph were materially false and misleading because as known to defendants, but undisclosed, the material cause for the losses in the mobile home loan portfolio was defendants' reckless underwriting and origination practices. The statements were additionally false and misleading for materially understating the loan loss amount for failing to include current mobile home loans. The sources for these allegations are contained in paragraphs 15, 56, 60, 61, 62, 63, 65, 66 supra, and 110, infra.

96. Defendant Potts issued a Letter to Shareholders dated April 18, 2003, which again attributed net losses to market conditions in the mobile home loan "market":

> **The weakness in the manufactured housing markets was a major contributor to the net loss for 2002.** The Company provided reserves for losses on manufactured housing loans of $29.9 million, and recorded impairment charges of $15.5 million on securities back by manufactured housing loans. These charges were necessary because the Company has exposure to credit losses on these assets. Unfortunately, the manufactured housing market continues to underperform, and 2003 will likely include significant charges to earnings.

Dynex 2002 Annual Report, p. 1 (Emphasis added).

97. The statements in the preceding paragraph were materially false and misleading because as known to defendants, but undisclosed, the material cause for the losses in the mobile home loan portfolio was defendants' reckless underwriting and origination practices. The statements were additionally false and misleading for materially understating the loan loss amount for failing to include current mobile home loans. The sources for these allegations are contained in paragraphs 15, 56, 60, 61, 62, 63, 65, 66 supra, and 110, infra.

98. The Dynex Form 10-K filed on that same date also contained a table as part of a section on "Credit Exposure" which purported to reflect delinquencies including from mobile home loans as follows:

> The following table summarizes single family mortgage loan, manufactured housing loan and commercial mortgage loan delinquencies as a percentage of the outstanding collateral balance for those structures in which Dynex has retained a portion of the direct credit risk included in the table above. The delinquencies as a percentage of the outstanding collateral increased to 2.71% at December 31, 2002, from 1.78% at December 31, 2001, **primarily from increasing delinquencies in the Company's manufactured housing loan and commercial mortgage loan portfolios** and a declining overall outstanding collateral balance as a result of prepayments. The Company monitors and evaluates its exposure to credit losses and has established reserves based upon anticipated losses, general economic conditions and trends in the investment portfolio. As of December 31, 2002, management believes the level of credit reserves is sufficient to cover any

losses that may occur as a result of current delinquencies presented in the table below.

Delinquency Statistics

December 31,	60 to 89 days delinquent	90 days and over delinquent (1)	Total
2000	0.37%	1.59%	1.96%
2001	0.28%	1.50%	1.78%
2002	0.64%	2.07%	2.71%

(1) Includes foreclosures, repossessions and REO.

Dynex 2002 Form 10-K at p. 23 (Emphasis added).

99. The statements contained in the preceding paragraph were materially false and misleading because Dynex materially underreported cumulative delinquency and repossession statistics for mobile home loans. The sources for these allegations are contained in paragraphs 15, supra, 102 and 112, infra.

In 2003, Dynex Expands Criteria For Calculating Loan Loss To Include The Percentage of 30-Day Delinquent Mobile Home Loans

100. Merit's 2002 Form 10-K, filed on April 15, 2003, described increases in loan loss provisions due to "under performance," of the portfolio and adverse "trends" and also the need to include a portion of all loans greater than 30 days delinquent:

> The Company provides for losses on its loans where it has retained credit risk. The Company provides for losses on its loans through a provision for loan losses. Provision for loan losses increased to $28.6 million in 2002 from $18.7 million in 2001. **The continuing under-performance of the Company's manufactured housing loan and securities portfolio prompted the company to revise its estimate of losses to include a percentage of all loans with delinquencies greater than 30 days.** Defaults in 2002 averaged 4.3% versus 4.2% in 2001, and loss severity remained at 77% during the year. *"Loss Severity"* is the cumulative loss incurred on a loan, or sub-set of loans, divided by the unpaid principal balance of such loan(s). **Should these trends continue, the Company will likely**

> **need to increase the provision for loan losses and will likely have increased other-than-temporary impairment charges on its manufactured housing debt securities portfolio.** Provision for losses for loans decreased to $18.7 million in 2001 from $28.5 million in 2000 and impairment charges increased to $15.8 million in 2001 from $5.5 million in 2000. Provision for losses and other-than-temporary impairment losses remained high in 2001 due to the under-performance of the Company's manufactured housing loan portfolio. **The increase in severe loan losses is a result of the saturation in the market place with both new and used (repossessed) manufactured housing units. In addition, the Company has seen some increase in overall default rates on its manufactured housing loans. Defaults in 2001 averaged 4.2% versus 3.4% in 2000, and loss severity increased from 70% to 77% during the year.**

Merit 2002 Form 10-K at p. 15-16 of 61. (Emphasis added).

101. The statements contained in the preceding paragraph were materially false and misleading because the causes of the mobile home loan's underperformance were known to defendants throughout the Class Period, and thus the expanded criteria for the loan loss calculation should have accrued throughout the Class Period. The sources for these allegations are contained in paragraphs 15, supra, 102 and 112, infra.

Dynex Disclose 34% Understatement of Previously Reported Cumulative Repossessions

102. Throughout the Class Period, Dynex issued monthly reports concerning the performance of the Series 12 and Series 13 Bond collateral, which appeared on its corporate web site. These reports, upon which rating agencies relied and upon which, in turn the bonds were priced, purported to contain detailed information concerning delinquencies and foreclosure of loans collateralizing the Bonds. However, each of these reports was materially false and misleading since none disclosed the true facts concerning the "origination of collateral"; the improper underwriting practices used to secure the collateral or that even "current" non-delinquent loans were in fact likely to be impaired given these underwriting practices.

103. Further, in September 2003 Dynex reported to the investing public on its website that the cumulative repossessions for the Series 13 Bond collateral was no more than $47.08 million.

104. On or about October 28, 2003, Dynex disclosed that the previously reported "cumulative REpo/Reo" figure had been understated by approximately 34% -- actual cumulative repossessions were actually $63 million as of September 2003.

105. Following the disclosure of this massive understatement of cumulative repossessions, in October 2003 Moody's initiated a Ratings Review of the Series 13 Bonds.

106. As reported in the November 2003 Mortgage Servicing News the five classes of the Series 13 Bonds were being reviewed for "possible downgrade" because of "high cumulative loss and insufficient spread overcollateralization has dropped from 10% to 5% of the original pool balance."

February 24, 2004 Moody's Downgrades Series 13 Class M1 Seventeen Grades and Class M2 Bonds Fifteen Grades

107. On February 24, 2004, Moody's issued massive downgrades of the Series 13 Bonds noting, inter alia, that worsening "cumulative repossession rates." The cumulative possession rates were the figures Dynex only began to report in October 2003. The Class M1 bonds were downgraded from Aa2 ("high quality bonds by all standards") to Ca ("speculative," "a high degree of which are often in default or have other market shortcomings") and Class M2 bonds were downgraded from A2 (bonds "having many favorable attributes" considered "upper medium grade obligations") to C (the "lowest rated class of bonds having extremely poor prospects of ever attaining any real investment standing"), representing an enormous descent in credit worthiness under the Moody's rating system.

108. Moody's downgrade resulted in an immediate disinterest by investors for the Series 13 Bonds. Over the next three months -- from February 24, 2004 through May 11, 2004, the Series 13 M1 and M2 Bonds were not priced on the Bloomberg Trading system. Once the Series 13 Bonds did resume trading it was only at dramatically reduced values, as follows:

MESC 13						
Certificate	**Class**	**Rating at Issuance (Moody's/Fitch)**	**Price on 2/24/04**	**Rating Downgrade 2/24/04**	**Next Trade (Trade Date)**	**% Decline**
MESC 13					**5/11/2004**	
	M1	Aa2/AA	$ 101.875	Ca "default probable"	$ 81.09	20%
	M2	A2/A	$ 94.625	C "imminent default"	$ 49.94	42%
					11/30/2004	
	B1		$ 102.40		$ 15.38	85%

March 2004 Downgrade of the Series 12 Bonds

109. On March 29, 2004 Fitch downgraded Merit manufactured housing contract Series 12, noting that due to, inter alia, "**relaxed credit standard**, overbuilding by manufacturers, and the difficulties relating to servicing this unique asset have all contributed to poor performance of manufactured housing securities."

2004 Merit Further Expands Loan Loss Calculation
to Include Percentage of "Current" Mobile Home Loans

110. The Company continued the façade of being supported by the performance of mobile home loans in its 2003 Form 10-K filed on April 15, 2004 when it claimed it was expanding the criteria for determining its loan loss provision to include even "current" mobile home loans based on "new observable data":

> Provision for loan losses decreased to $18.6 million in 2003 from $28.6 million in 2002. Included in provision for loan losses is $6.1 million recorded in 2003 specifically for currently existing credit losses within outstanding manufactured housing loans that are current as to payment but which the Company has determined to be impaired. Previously, the Company had not considered current loans to be impaired under generally accepted accounting principles and therefore had not previously provided for the impairment of these loans. Continued worsening trends in both the industry as a whole and the Company's pools of manufactured housing loans prompted the Company to prepare extensive analysis on these pools of loans. The Company has not originated any new manufactured housing loans since 1999, and has extensive empirical data on the historical performance of this static pool of loans. **The Company analyzed performance and default activity for loans that were current at various points in time over the last 36 months, and based on that analysis, identified default trends on these loans. The Company also considered current market conditions in this analysis, with the expectation that these market conditions would continue for the foreseeable future. Given this new observable data, the Company now believes the inclusion of amounts in the provision for loan losses for loans which are current as to payment is an appropriate application of the definition of impairment within generally accepted accounting principles, and has accounted for this provision as a change in accounting estimate and, accordingly, recorded the amount as additional provision for loan losses.** The Company continues to experience unfavorable results in its manufactured housing loan portfolio in terms of elevated delinquencies and loss severity. Within each non-recourse securitization financing, a group of loans are held within the securitization structure as additional support for potential credit losses and to provide additional cash flow to cover such credit losses. Once the cumulative level of losses surpassed the cash flow available from the credit reserve and losses have depleted the over-collateralization, future losses are passed to the holders of the lowest classes of bonds within the structure. In one of the securitization structures of the Company, total cumulative losses have surpassed the level of the cash flow available from the credit reserve and have completely depleted the over-collateralization. During the three months ended December 31, 2003, losses on this securitization began to pass to the subordinate class bondholders. As the

> over-collateralization has been depleted in the current year, the Company's provision for loan losses correspondingly declined.

Merit 2003 Form 10-K, p. 8 (Emphasis added).

> Provision for loan losses increased to $28.6 million in 2002 from $18.7 million in 2001. Provision for losses increased by $9.9 million as a result of additions for manufactured housing loans. The continuing under-performance of these loans prompted the Company to revise its estimate of losses to include a percentage of all loans with delinquencies greater than 30 days. This revision, which was instituted during the fourth quarter of 2002, resulted in an increase in provision for losses of $7.4 million during the quarter. **Loss severity on the manufactured housing loans continued to remain high during 2002 as a result of the saturation in the market place with both new and used (repossessed) manufactured housing units.** Defaults in 2002 on manufactured housing loans averaged 4.5%, versus 4.2% in 2001, and loss severity continued at 77% during the year.

Id. pp. 8-9. (Emphasis added).

111. The statements in preceding paragraph were materially false and misleading since the material causes for the additional provision including the defective collateral quality arising from reckless underwriting and origination practices was known, or recklessly disregarded, by Defendants since the time of origination and/or the commencement of the Class Period. The sources for these allegations are contained in paragraphs 15, 56, 60, 61, 62, 63, 64, 65, 66, supra.

Merit Admitted "Internal Control Deficiencies" In Recording Allowance for Loan Losses Requiring A Restatement

112. Merit's 2003 Form 10-K filed on April 15, 2004 also disclosed internal control deficiencies requiring restatements precisely in the area of recording loan losses in excess of loan obligations as follows:

> The Company identified an internal control deficiency related to the recording of allowance for loan losses in excess of loss obligations. The Company will restate the interim periods of June 30, 2003 and September 30, 2003 as a result of the deficiency. Management believes that it has performed the appropriate procedures to ensure that the information included herein for the year ended December 31, 2003 is materially accurate in all reasonable aspects. This internal

control deficiency did not impact the consolidated financial statements of the Company's parent.

Merit 2003 Form 10-K, p. 30.

113. The statements in the preceding paragraph were materially false and misleading because the basis for the change of the criteria for loan loss allocation was known to defendants throughout the Class Period, which included, inter alia, defendants' reckless underwriting and origination practices. The sources for these allegations are contained in paragraphs 15, 56, 60, 61, 62, 63, 64, 65, 66, supra.

May 17, 2004 Series 12 Bonds Collapse Following Substantial Rating Downgrade

114. Following Fitch's massive downgrade of the Series 12 Bonds on May 10, 2004, the trading price of the Series 12 Bonds declined precipitously on average by 41% as follows:

MESC 12									
Certificate	**Class**	**Rating at Issuance (Moody's/Fitch)**	**3/10/2004**	**Fitch Downgrade 3/10/2004**	**3/12/2004**	**% Decline**	**Moody's Downgrade 5/13/2004**	**5/17/2004**	**% Decline**
MESC 12	1M1	Aa2/AA	$ 100.22	A	$ 100.16	0%	Ca	$ 75.56	-18%
	1M2	A2/A	$ 100.22	BBB-	$ 92.00	-8%	C	$ 52.44	-33%
	1B	BBB	$ 100.13	BB-	$ 89.66	-10%	C	$ 23.25	-72%

Scienter

115. Defendants' recklessness and/or actual knowledge of the true adverse information concerning the collateral for Series 12 and Series 13 Bonds is reflected in the following facts alleged herein:

(a) the systematic disregard for creditworthiness of the borrower was a "top down" policy since: (i) the Underwriting Guidelines were typically waived on the regional branch and corporate levels (¶¶10, 55, 60); and (ii) the sales approach used to convince mobile home dealers to refer

contracts also was implemented across many offices and regions (¶¶ 10, 56, 59, 60);

(b) Dynex artificially kept reported delinquencies through the end of 1999 below 2% (¶¶ 10, 64);

(c) Defendants knew, or recklessly disregarded, that 65% - 70% of its mobile home loan collateral were Buy For loans (¶¶ 10, 61, 62);

(d) By the time of the commencement of the Class Period on February 7, 2000, Dynex had had substantial collection experience with the mobile home loans originated between 1996 and 1999, and thus had actual knowledge of high delinquencies and loss severities due to undisclosed high percentage of Buy For loans (id.); high percentages of First Payment default due to mobile home dealer misrepresentations, or other filed documentation reviewed in the course of collection activities revealed the borrower was not creditworthy a the time the loan was originated (¶¶ 11, 63).

(e) The statements in April 2003 and April 2004 that purported to expand, based on recent events and performance data, the collateral loans included in the loan loss provision to "30 day delinquent" and then "current" loans was materially false and misleading because defendants knew the true causes for the poor performance of the collateral was not merely "recent events," but a result of Dynex's reckless underwriting and origination practices (¶¶ 8, 13, 100, 110);

(f) The admitted “erroneous” reporting of cumulative repossessions in October 203, resulting in approximately 34% understatement of the amount of cumulative repossessions is indicative of defendants’ intentional and/or reckless disregard of “Master Servicers” duties and responsibilities described to investors (¶¶ 102, 103, 104); and

(g) The admitted “deficiencies in internal controls” assessing and determining the loan loss provision with respect to Bond collateral (which in turn resulted in the restatement of 2003 interim financial statements) reflect defendants intentional and/or reckless disregard of Master Servicer functions as described to investors (¶¶ 112).

No Safe Harbor

116. The statutory safe harbor provided for forward-looking statements under certain circumstances does not apply to any of the allegedly false statements pleaded in this complaint. Many of the specific statements pleaded herein were not identified as "forward-looking statements" when made. To the extent there were any forward-looking statements, there were no meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the purportedly forward-looking statements. Alternatively, to the extent that the statutory safe harbor does apply to any forward-looking statements pleaded herein, defendants are liable for purportedly those false forward-looking statements because at the time each of those purportedly forward-looking statements was made, the particular speaker knew that the particular forward-looking statement was false, and/or the forward-looking statement was

authorized and/or approved by an executive officer of Merit who knew that those statements were false when made**.**

COUNT I

(Against The Company and the Individual Defendants For Violation of Section 10(b) of the Exchange Act and Rule 10b-5 of the Securities and Exchange Commission)

117. Plaintiff repeats and realleges each and every allegation contained in the foregoing paragraphs as if fully set forth herein.

118. This Count is asserted against all defendants and is based upon Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5 promulgated thereunder.

119. During the Class Period, defendants, singularly and in concert, directly engaged in a common plan, scheme, and unlawful course of conduct, pursuant to which they knowingly or recklessly engaged in acts, transactions, practices, and courses of business which operated as a fraud and deceit upon plaintiff and the other members of the Class, and made various deceptive and untrue statements of material facts and omitted to state material in order to make the statements made, in light of the circumstances under which they were made, not misleading to plaintiff and the other members of the Class, including statements in the Prospectus concerning "origination collateral" and monthly reports regarding performance of collateral and delinquencies and repossessions. The purpose and effect of said scheme, plan, and unlawful course of conduct was, among other things, to induce plaintiff and the other members of the Class to purchase Merit Series 12 and Series 13 Bonds during the Class Period at artificially inflated prices.

120. During the Class Period, defendants, pursuant to said scheme, plan, and unlawful course of conduct, knowingly and/or recklessly issued, caused to be issued, participated in the issuance of, the preparation and issuance of deceptive and materially false and misleading statements to the investing public as particularized above.

121. Throughout the Class Period, the Company acted through the Individual Defendants, whom it portrayed and represented to the financial press and public as its valid representative. The knowledge and/or recklessness of the Individual Defendants are therefore imputed to Merit, which is primarily liable for the securities law violations while acting in their official capacities as Company representatives, or, in the alternative, which is liable for the acts of the Individual Defendants under the doctrine of respondent superior.

122. As a result of the dissemination of the false and misleading statements set forth above, the market price of the Series 12 and Series 13 Bonds was artificially inflated during the Class Period. In ignorance of the false and misleading nature of the statements described above and the deceptive and manipulative devices and contrivances employed by said defendants, plaintiff and the other members of the Class relied, to their detriment, on the integrity of the market price of the bonds in purchasing Merit Series 12 and Series 13 Bonds. Had plaintiff and the other members of the Class known the truth, they would not have purchased said shares or would not have purchased them at the inflated prices that were paid.

123. Plaintiff and the other members of the Class have suffered substantial damages as a result of the wrongs herein alleged in an amount to be proved at trial.

124. By reason of the foregoing, defendants directly violated Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder in that they: (a) employed devices,

schemes, and artifices to defraud; (b) made untrue statements of material facts or omitted to state material facts in order to make the statements made, in light of the circumstances under which they were made, not misleading; or (c) engaged in acts, practices, and a course of business which operated as a fraud and deceit upon plaintiff and the other members of the Class in connection with its purchases of Merit Series 12 and 13 Bonds during the Class Period.

COUNT II

(Against The Individual Defendants For
Violation of Section 20(a) of the Exchange Act)

125. Plaintiff repeats and realleges each and every allegation contained in each of the foregoing paragraphs as if set forth fully herein.

126. The Individual Defendants, by virtue of their positions, stock ownership and/or specific acts described above, were, at the time of the wrongs alleged herein, controlling persons within the meaning of Section 20(a) of the Exchange Act.

127. The Individual Defendants had the power and influence and exercised the same to cause the Company to engage in the illegal conduct and practices complained of herein.

128. By reason of the conduct alleged in Count I of the Complaint, the Individual Defendants are liable for the aforesaid wrongful conduct, and are liable to plaintiff and to the other members of the Class for the substantial damages which they suffered in connection with its purchases of the Series 12 and 13 Bonds during the Class Period.

WHEREFORE, plaintiff prays for relief and judgment, as follows:

(a) Determining that this action is a proper class action and certifying plaintiff as a class representative under Rule 23 of the Federal Rules of Civil Procedure;

(b) Awarding compensatory damages in favor of plaintiff and the other Class members against all defendants, jointly and severally, for all damages sustained as a result of defendants' wrongdoing, in an amount to be proven at trial, including interest thereon;

(c) Awarding plaintiff and the Class their reasonable costs and expenses incurred in this action, including counsel fees and expert fees; and

(d) Such other and further relief as the Court may deem just and proper.

JURY TRIAL DEMANDED

Plaintiff hereby demands a trial by jury.

Dated: May 31, 2005

SCHOENGOLD SPORN LAITMAN & LOMETTI, P.C.

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CERTIFICATE OF SERVICE

I, Frank R. Schirripa, one of the attorneys for Lead Plaintiff, Teamsters Local 445 Freight Division Pension Fund, hereby certify that on May 31, 2005, Lead Plaintiff's Amended Class Action Complaint was filed with the Clerk of the Court and served by overnight mail on the following:

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