LITCHFIELD FINANCIAL CORP /MA

FORM 10-K/A
(Amended Annual Report)

Filed 05/04/99 for the Period Ending 12/31/98

Address	430 MAIN STREET WILLIAMSTOWN, MA 01267
Telephone	4134581000
CIK	0000882515
SIC Code	6162 - Mortgage Bankers and Loan Correspondents
Fiscal Year	12/31

LITCHFIELD FINANCIAL CORP /MA

FORM 10-K/A
(Amended Annual Report)

Filed 5/4/1999 For Period Ending 12/31/1998

Address	430 MAIN STREET
	WILLIAMSTOWN, Massachusetts 01267
Telephone	413-458-1000
CIK	0000882515
Fiscal Year	12/31

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K/A

Ammendment No. 1

ANNUAL REPORT PURSUANT to SECTION 13 or 15(d) of THE SECURITIES EXCHANGE ACT of 1934

For the fiscal year ended DECEMBER 31, 1998

Commission File Number: 0-19822

LITCHFIELD FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

MASSACHUSETTS

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                    04-3023928
                               (State or other jurisdiction
(I.R.S. Employer Identification No.)
                          of incorporation or organization)

 430 MAIN STREET, WILLIAMSTOWN, MA                                  01267
(Address of principal executive offices)                           (Zip Code)

Registrant's telephone number, including area code: (413) 458-1000
    Securities registered pursuant to Section 12(b) of the Act: None
      Securities registered pursuant to Section 12(g) of the Act:


 Common Stock ($.01 par value)
       (Title of class)
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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No

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

The aggregate market value of the voting stock held by nonaffiliates of the registrant as of March 15, 1999 was $117,571,000 (based on the closing price of the Company's common stock on The Nasdaq Stock Market's National Market.)

The number of outstanding shares of common stock as of March 15, 1999 was 6,886,873 shares.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the annual stockholders report for the year ended December 31, 1998 are incorporated by reference into Parts I and II.

Portions of the proxy statement for the Annual Meeting of Stockholders held on April 23, 1999 are incorporated by reference into Part III.

EXPLANATORY NOTE

Exhibit 13.1 to the Company's Annual Report on Form 10-K for the year ended December 31, 1998 is amended to correct the omissions of the signature lines in the following sections: "Report of Management" and "Report of Independent Auditors".

(ANNUAL REPORT)

1998 ANNUAL REPORT

10 Year Anniversary
[graph showing eps]

Income Per Share Before Extraordinary Item

LITCHFIELD FINANCIAL CORPORATION is a diversified finance company that provides financing to creditworthy borrowers for assets not typically financed by banks. The Company provides such financing by purchasing consumer loans and by making loans to businesses secured by consumer receivables or other assets.

Through the support of its investors and dedication of its employees, Litchfield has been able to provide quality service, maintain consistent growth and be among the top performers in the financial services industry. Litchfield's common stock trades on The Nasdaq Stock Market's National Market under the symbol "LTCH" and is listed in some newspapers as "LITCHFNL".

Revenue Growth

(000's)

[Graph showing Revenue Growth]

Dear Fellow Stockholders:

It is a great privilege to write this letter reviewing our 1998 results on this, the tenth anniversary of our founding and our tenth consecutive year of at least 20% earnings growth. Before starting to write this letter, I outlined key events of 1998, wrote down the fundamentals on which we base our business and reread our last several annual reports. In doing so, I was struck by the magnitude of our achievements, the strength of our fundamentals and the extraordinary consistency of our growth.

At the risk of repeating myself, 1998 was a record year for the Company. Our income and earnings per share, before extraordinary item, were up 34% and 20%, respectively. Our revenues were up 31%, while the percentage of our revenues derived from gain on sale of loans declined for the fourth straight year. Our overhead expenses as a percent of the serviced portfolio decreased to less than 2% of the portfolio for the first time. And while we managed dramatic growth in loan originations and the serviced portfolio, we decreased our delinquencies and charge-off rates as well. As we did in 1995, in 1998 we doubled our originations over the previous year. The corresponding growth in our loan portfolio, and the resulting increase in interest income, allowed us to offset the dilutive effect on earnings per share of our mid-year equity offering while we increased our cash revenues. The equity offering also added to the strength of our balance sheet and laid the groundwork for future growth.

These results reflect the strength of our team and our business model. We recruit, train, and retain outstanding people with intelligence, integrity and strong work ethics. It is gratifying to work with the talented people who make this company successful. A substantial part of the employee's net worth resides in the Company's continued success. Important elements in that success are our obsession with our business plan and our focus on consistent growth. We continue to concentrate on under-served niche markets like our land and timeshare businesses. We also apply our successful formula to new businesses such as our financial services business which experienced extraordinary growth in 1998.

In the same way, we look to expand into other niche markets with similar characteristics to propel our future growth. And, as always, we continue to tightly control the growth in our expenses.

We believe our Company is unique in the financial services business. Because we are frequently measured against many of the other public companies in the financial sector, it may be helpful to point out how we are different. First is our ten-year track record of consistent growth and profitability which demonstrates the strength of our management team and our focus on the fundamentals of our business. Second is our committed loan sale facilities at fixed spreads over commercial paper rates. These facilities enable us to continue to sell loans at a time when many finance companies face widening spreads and a lack of liquidity in the asset-backed lending market. Third is the cash positive nature of our loan sales. We generally buy our loans at a discount and derive proceeds not only from the sale of the loans, but also from pledging our retained interests in the loan sales. Fourth is our lower origination cost compared to many retail finance companies. We don't have to pay competitive premiums to brokers to channel loans to us. In fact, in many cases we are the exclusive source of financing to our dealer and developer network. Fifth, because we focus on under-served market niches, we can be selective in our underwriting. We lend money to customers who are good credit risks and, in most cases, these loans are supported by dealer reserves, guarantees or with conservative loan to value ratios and advance rates. Finally, we believe we are under- leveraged compared with our peers, so we have room to further increase our debt and improve our return on equity. We feel that all of these factors contribute to our achievements.

I would like to thank all of our shareholders as well as our employees, bondholders, lenders, customers and other partners for their continued support. We appreciate your enthusiasm for our business and we look forward to another rewarding year in 1999.

RANDY STRATTON
Chief Executive Officer and President

January 30, 1999

SELECTED CONSOLIDATED FINANCIAL INFORMATION
(Dollars in thousands, except per share data)

	Year Ended December 31,				
Statement of Income Data (1):	1998	1997	1996	1995	1994
Revenues:					
Interest and fees on loans	$25,736	$19,374	$14,789	$ 11,392	$5,669
Gain on sale of loans	10,691	8,564	7,331	5,161	4,847
Servicing and other income	2,379	1,753	1,576	908	459
Total revenues	38,806	29,691	23,696	17,461	10,975
Expenses:					
Interest expense	14,265	10,675	7,197	6,138	3,158
Salaries and employee benefits	4,806	3,399	2,824	2,798	1,776
Other operating expenses	3,834	3,480	3,147	2,120	1,164
Provision for loan losses	1,532	1,400	1,954	890	559
Total expenses	24,437	18,954	15,122	11,946	6,657
Income before income taxes and extraordinary item	14,369	10,737	8,574	5,515	4,318
Provision for income taxes	5,537	4,134	3,301	2,066	1,619
Income before extraordinary item	8,832	6,603	5,273	3,449	2,699
Extraordinary item (2)	(77)	(220)	---	---	(126)
Net income	$8,755	$6,383	$5,273	$3,449	$2,573
Basic per common share amounts:					
Income before extraordinary item	$ 1.41	$ 1.19	$ .97	$ .80	$ .66
Extraordinary item	(.01)	(.04)	--	--	(.03)
Net income per share	$ 1.40	$ 1.15	$ .97	$ .80	$ .63
Basic weighted average number of shares outstanding	6,273,638	5,572,465	5,441,636	4,315,469	4,116,684
Diluted per common share amounts:					
Income before extraordinary item	$ 1.34	$ 1.12	$ .93	$ .76	$ .63
Extraordinary item	(.01)	(.04)	--	--	(.03)
Net income per share	$ 1.33	$ 1.08	$ .93	$ .76	$ .60
Diluted weighted average number of shares outstanding	6,604,367	5,909,432	5,682,152	4,524,607	4,282,884
Cash dividends declared per common share	$ .07	$ .06	$ .05	$ .04	$ .03
Other Statement of Income Data:					
Income before extraordinary item as a percentage of revenues	22.8%	22.3%	22.3%	19.8%	24.6%
Ratio of EBITDA to interest expense (3)	2.13	2.17	2.90	2.44	3.31
Ratio of earnings to fixed charges (4)	2.01	2.01	2.19	1.90	2.37
Return on average assets (5)	3.7%	3.8%	4.0%	3.7%	4.6%
Return on average equity (5)	13.2%	14.1%	13.3%	16.6%	17.2%

(1) Certain amounts in the 1994 through 1996 financial information have been restated to conform to the 1997 and 1998 presentation.
(2) Reflects loss on early extinguishment of a portion of the 1992 Notes (as defined herein), net of applicable tax benefit of $76,000, for 1994,

of the remainder of the 1992 Notes, net of applicable tax benefit of $138,000, for 1997, and of the term note payable, net of applicable tax benefit of $48,000, for 1998.
(3) The ratio of EBITDA to interest expense is required to be calculated for the twelve month period immediately preceding each calculation date, pursuant to the terms of the indentures to which the Company is subject. EBITDA is defined as earnings before deduction of taxes, depreciation, amortization, and interest expense (but after deduction for any extraordinary item).
(4) For purposes of calculating the ratio of earnings to fixed charges, earnings consist of income before income taxes and extraordinary items and fixed charges. Fixed charges consist of interest charges and the amortization of debt expense.
(5) Calculations are based on income before extraordinary item.

SELECTED CONSOLIDATED FINANCIAL INFORMATION - (Continued)
(Dollars in thousands, except per share data)

	December 31,				
Balance Sheet Data (6):	1998	1997	1996	1995	1994
Total assets............	$293,882	$186,790	$152,689	$112,459	$63,487
Loans held for sale (7).....................	19,750	16,366	12,260	14,380	11,094
Other loans (7).........	191,292	86,307	79,996	33,613	15,790
Retained interests in loan sales (7)..........	28,883	30,299	28,912	22,594	11,996
Secured debt............	50,521	5,387	43,727	9,836	5,823
Unsecured debt..........	134,588	105,347	46,995	47,401	29,896
Stockholders' equity....	82,094	52,071	42,448	37,396	16,610

	Year Ended December 31,				
Other Financial Data:	1998	1997	1996	1995	1994
Loans purchased and originated (8)............	$375,292	$184,660	$133,750	$121,046	$ 59,798
Loans sold (8)............	144,762	98,747	54,936	65,115	40,116
Loans participated (8)....	3,569	6,936	---	---	---
Serviced Portfolio (9)....	466,912	304,102	242,445	176,650	105,013
Loans serviced for others....................	238,132	179,790	129,619	111,117	72,731
Dealer/developer reserves..................	9,979	10,655	10,628	9,644	6,575
Allowance for loan losses (10)...............	6,707	5,877	4,528	3,715	1,264
Allowance ratio (11)......	1.44%	1.93%	1.87%	2.10%	1.20%
Delinquency ratio (12)....	0.95%	1.20%	1.34%	1.73%	.93%
Net charge-off ratio (8)(13)...................	.58%	.74%	.94%	.67%	.38%
Non-performing asset ratio (14)................	0.84%	1.03%	1.57%	1.35%	1.02%

(6) In 1997 the Company adopted Statement of Financial Accounting Standards No. 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." Consequently, certain amounts included in the 1994 through 1996 financial statements have been reclassified to conform with the 1997 and 1998 presentation:
"Subordinated pass through certificates held to maturity," "Excess servicing asset" and "Allowance for loans sold" have been reclassified as "Retained interests in loan sales." In addition, "Loans held for investment" have been reclassified as "Other loans."
(7) Amount indicated is net of allowance for losses and recourse obligation on retained interests in loan sales.
(8) During the relevant period.
(9) The Serviced Portfolio consists of the principal amount of loans serviced by or on behalf of the Company, except loans participated without recourse to the Company.
(10) The allowance for loan losses includes estimated recourse obligations for loans sold.
(11) The allowance ratio is the allowances for loan losses divided by the amount of the Serviced Portfolio.
(12) The delinquency ratio is the amount of delinquent loans divided by the amount of the Serviced Portfolio. Delinquent loans are those which are 31 days or more past due which are not covered by dealer/developer reserves or guarantees and not included in other real estate owned.
(13) The net charge-off ratio is determined by dividing the amount of net charge-offs for the period by the average Serviced Portfolio for the period.
(14) The non-performing asset ratio is determined by dividing the sum of the amount of those loans which are 91 days or more past due and other real estate owned by the amount of the Serviced Portfolio.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

Litchfield Financial Corporation (the "Company") is a diversified finance company that provides financing to creditworthy borrowers for assets not typically financed by banks. The Company provides such financing by purchasing consumer loans and by making loans to businesses secured by consumer receivables or other assets.

The Company purchases consumer loans (the "Purchased Loans") consisting primarily of loans to purchasers of rural and vacation properties ("Land Loans") and vacation ownership interests popularly known as timeshare interests ("VOI Loans"). The Company also provides financing to rural land dealers, timeshare resort developers and other finance companies secured by receivables ("Hypothecation Loans") and to dealers and developers for the acquisition and development of rural land and timeshare resorts ("A&D Loans"). In addition, the Company purchases other loans, such as consumer home equity loans, mortgages and construction loans and tax lien certificates, and provides financing to other businesses secured by receivables or other assets ("Other Loans").

Land Loans are typically secured by one to twenty acre rural parcels. Land Loans are secured by property located in 36 states, predominantly in the southern United States. VOI Loans typically finance the purchase of ownership interests in fully furnished vacation properties. VOI Loans are secured by property located in 18 states, predominantly in California, Florida and Pennsylvania. The Company requires most dealers or developers from whom it buys loans to guarantee repayment or replacement of any loan in default. Ordinarily, the Company retains a percentage of the purchase price as a reserve until the loan is repaid.

The Company extends Hypothecation Loans to land dealers, resort developers and other finance companies secured by receivables. Hypothecation Loans typically have advance rates of 75% to 90% of the current balance of the pledged receivables and variable interest rates based on the prime rate plus 2.0% to 4.0%.

The Company also makes A&D Loans to land dealers and resort developers for the acquisition and development of rural land and timeshare resorts in order to finance additional receivables generated by the A&D Loans. At the time the Company makes A&D Loans, it typically receives an exclusive right to purchase or finance the related consumer receivables generated by the sale of the subdivided land or timeshare interests. A&D Loans typically have loan to value ratios of 60% to 80% and variable interest rates based on the prime rate plus 2.0% to 4.0%.

The principal sources of the Company's revenues are (i) interest and fees on loans, (ii) gains on sales of loans and (iii) servicing and other income. Gains on sales of loans are based on the difference between the allocated cost basis of the assets sold and the proceeds received, which includes the fair value of any assets or liabilities that are newly created as a result of the transaction. Because a significant portion of the Company's revenues is comprised of gains realized upon sales of loans, the timing of such sales has a significant effect on the Company's results of operations.

Results of Operations

The following table sets forth the percentage relationship to revenues, unless otherwise indicated, of certain items included in the Company's statements of income.

	Year ended December 31, 1998	1997	1996
Revenues			
Interest and fees on loans........	66.3%	65.3%	62.4%
Gain on sale of loans.............	27.6	28.8	30.9
Servicing and other income........	6.1	5.9	6.7
	100.0	100.0	100.0
Expenses			
Interest expense..................	36.8	36.0	30.4
Salaries and employee benefits....	12.4	11.4	11.9
Other operating expenses..........	9.9	11.7	13.3
Provision for loan losses.........	3.9	4.7	8.2
	63.0	63.8	63.8
Income before income taxes and extraordinary item....................	37.0	36.2	36.2
Provision for income taxes............	14.2	13.9	13.9
Income before extraordinary item......	22.8	22.3	22.3
Extraordinary item, net...............	(0.2)	(0.8)	--
Net income............................	22.6%	21.5%	22.3%

Year Ended December 31, 1998 Compared to Year Ended December 31, 1997

Revenues increased 30.7% to $38,806,000 for the year ended December 31, 1998, from $29,691,000 for the year ended December 31, 1997. Net income for the year ended December 31, 1998 increased 37.2% to $8,755,000 compared to $6,383,000 in 1997. Net income as a percentage of revenues was 22.6% for the year ended December 31, 1998 compared to 21.5% for the year ended December 31, 1997. Loan purchases and originations grew 103.2% to $375,292,000 in 1998 from $184,660,000 in 1997. The Serviced Portfolio increased 53.5% to $466,912,000 at December 31, 1998 from $304,102,000 at December 31, 1997.

Interest and fees on loans increased 32.8% to $25,736,000 in 1998 from $19,374,000 in 1997, primarily as the result of the higher average balance of other loans during the 1998 period. The average rate earned on the Serviced Portfolio decreased to 11.7% at December 31, 1998 from 12.2% at December 31, 1997, primarily due to the effect of the growth in Hypothecation Loans as a percentage of the portfolio and a decline in interest rates. Hypothecation Loan yields are usually less than Land Loan or VOI Loan yields, but servicing costs and loan losses are generally less as well.

Gain on the sale of loans increased 24.8% to $10,691,000 in 1998 from $8,564,000 in 1997. The volume of loans sold increased 46.6% to $144,762,000 for the year ended December 31, 1998 from $98,747,000 for the same period in 1997. Gain on sale of loans increased less than the volume of loans sold for the year ended December 31, 1998 primarily due to the increase in Hypothecation Loans sold. The yield on the sale of Hypothecation Loans is significantly less than the typical yield on sales of consumer receivables primarily due to shorter average maturities and the nature of the underlying collateral.
Servicing and other income increased 35.7% to $2,379,000 for the year ended December 31, 1998, from $1,753,000 for the year ended December 31, 1997 largely due to the increase in the other fee income including certain processing fees, prepayment penalties and income from an affiliate. Loans serviced for others increased 32.5% to $238,132,000 as of December 31, 1998 from $179,790,000 at December 31, 1997.

Interest expense increased 33.6% to $14,265,000 in 1998 from $10,675,000 in 1997. The increase in interest expense primarily reflects an increase in average borrowings which was only partially offset by lower rates. During the year ended December 31, 1998, the weighted average borrowings were $150,483,000 at an average rate of 8.7% compared to $107,900,000 at an average rate of 9.1% during the year ended December 31, 1997. Interest expense includes the amortization of deferred debt issuance costs.

Salaries and employee benefits increased 41.4% to $4,806,000 for the year ended December 31, 1998 from $3,399,000 for the year ended December 31, 1997 because of an increase in the number of employees in 1998 and, to a lesser extent, an increase in salaries. Personnel costs as a percentage of revenues increased slightly to 12.4% in 1998 compared to 11.4% in 1997. However, as a percentage of the Serviced Portfolio, personnel costs decreased to 1.0% for the year ended December 31, 1998 from 1.1% for the year ended December 31, 1997. The increase in salaries and employee benefits was due in part to bringing customer service and collections in-house during 1998. This resulted in a decrease in third party servicing expenses included in other operating expenses. Total salaries and employee benefits plus other operating expenses as a percentage of revenues decreased in 1998 to 22.3% from 23.2% in 1997.

Other operating expenses increased 10.2% to $3,834,000 for the year ended December 31, 1998 from $3,480,000 for the year ended December 31, 1997. Other operating expenses increased due to the growth in the Serviced Portfolio that was only partially offset by the decrease in third party servicing expenses related to bringing customer service and collections in-house. As a percentage of revenues, other operating expenses decreased to 9.9% in 1998 from 11.7% in 1997. As a percentage of the Serviced Portfolio, other operating expenses decreased to 0.8% for the year ended December 31, 1998 compared to 1.1% for the year ended December 31, 1997.

During the year ended December 31, 1998, the provision for loan losses increased 9.4% to $1,532,000 from $1,400,000 for the year ended December 31, 1997 primarily due to the growth of the Serviced Portfolio.

Year Ended December 31, 1997 Compared to Year Ended December 31, 1996

Revenues increased 25.3% to $29,691,000 for the year ended December 31, 1997, from $23,696,000 for the year ended December 31, 1996. Net income for 1997 increased 21.1% to $6,383,000 compared to $5,273,000 in 1996. Net income as a percentage of revenues was 21.5% for the year ended December 31, 1997 compared to 22.3% for the year ended December 31, 1996. Loan purchases and originations grew 38.1% to $184,660,000 in 1997 from $133,750,000 in 1996. The Serviced Portfolio increased 25.4% to $304,102,000 at December 31, 1997 from $242,445,000 at December 31, 1996.

Interest and fees on loans increased 31.0% to $19,374,000 in 1997 from $14,789,000 in 1996, primarily as the result of the higher average balance of loans held for sale and other loans during 1997. The average rate earned on loans owned and retained interests in loan sales decreased to 12.2% for the year ended December 31, 1997 from 12.5% for the year ended December 31, 1996, primarily due to the effect of the growth in Hypothecation Loans and A&D Loans as a percentage of the Serviced Portfolio. Hypothecation Loan and A&D Loan yields are usually less than Land Loan or VOI Loan yields, but servicing costs and loan losses are generally less as well.

Gain on the sale of loans increased 16.8% to $8,564,000 in 1997 from $7,331,000 in 1996. The volume of loans sold increased 79.7% to $98,747,000 for the year ended 1997 from $54,936,000 for the same period in 1996. Gain on sale of loans increased less than the volume of loans sold for the year ended December 31, 1997 primarily due to the lower yield on the sale of Hypothecation Loans in 1997 and, to a lesser extent, the lower amount of discount relating to loans sold.

Servicing and other fee income increased 11.2% to $1,753,000 for the year ended December 31, 1997, from $1,576,000 for the year ended December 31, 1996 mostly due to the increase in other fee income resulting from the collection of significant prepayment penalties from a Hypothecation Loan and an A&D Loan in 1997. Although loans serviced for others increased 38.7% to $179,790,000 at December 31, 1997 from $129,619,000 at December 31, 1996, servicing income remained relatively constant due to a decrease in the average servicing fee per loan primarily as the result of the decrease in the number of purchased VOI Loans in the Serviced Portfolio.

Interest expense increased 48.3% to $10,675,000 for 1997, from $7,197,000 in 1996. The increase in interest expense primarily reflects an increase in average borrowings that were only partially offset by a decrease in average rates. During the year ended December 31, 1997, borrowings averaged $107,900,000 at an average rate of 9.1% compared to $71,800,000 and 9.3%, respectively, during 1996. Interest expense includes the amortization of deferred debt issuance costs.

Salaries and employee benefits increased 20.4% to $3,399,000 for the year ended December 31, 1997 from $2,824,000 for the year ended December 31, 1996 because of an increase in the number of employees and, to a lesser extent, an increase in salaries. Personnel costs as a percentage of revenues decreased slightly to 11.4% for the year ended December 31, 1997 compared to 11.9% in 1996. As a percentage of the Serviced Portfolio, personnel costs decreased to 1.12% for the year ended December 31, 1997 from 1.16% for the same period in 1996.

Other operating expenses increased 10.6% to $3,480,000 for the year ended December 31, 1997 from $3,147,000 for the same period in 1996 primarily as the result of the growth in the Serviced Portfolio. As a percentage of revenues, other operating expenses decreased to 11.7% in 1997 compared to 13.3% in 1996. As a percentage of the Serviced Portfolio, other operating expenses decreased to 1.14% for 1997 from 1.30% for 1996.

During 1997, the provision for loan losses decreased 28.4% to $1,400,000 from $1,954,000 in 1996. The provision for loan losses decreased despite the increase in loans owned and retained interests in loans sold because of the growth in Hypothecation Loans as a percentage of the Serviced Portfolio. Hypothecation Loans have experienced significantly lower delinquency and default rates than Purchased Loans.

Liquidity and Capital Resources

The Company's business requires continued access to short and long-term sources of debt financing and equity capital. The Company's principal cash requirements arise from loan originations, repayment of debt on maturity and payments of operating and interest expenses. The Company's primary sources of liquidity are loan sales, short-term borrowings under secured lines of credit and long-term debt and equity offerings.

Since its inception, the Company has sold $492,960,000 of loans at face value ($348,198,000 through December 31, 1997). The principal amount remaining on the loans sold was $238,132,000 at December 31, 1998 and $179,790,000 at December 31, 1997. In connection with certain loan sales, the Company commits to repurchase from investors any loans that become 90 days or more past due. This obligation is subject to various terms and conditions, including, in some instances, a limitation on the amount of loans that may be required to be repurchased. There were approximately $12,750,000 of loans at December 31, 1998 which the Company could be required to repurchase in the future should such loans become 90 days or more past due. The Company repurchased $491,000, $740,000 and $991,000 of such loans under the recourse provisions of loan sales 1998, 1997 and 1996, respectively. As of December 31, 1998, $25,685,000 of the Company's cash was restricted as credit enhancement for certain securitization programs. To date, the Company has participated $10,505,000 of A&D and Other Loans without recourse to the Company ($6,936,000 through December 31, 1997).

The Company funds its loan purchases in part with borrowings under various lines of credit. Lines are paid down when the Company receives the proceeds from the sale of the loans or when cash is otherwise available. These lines of credit totaled $116,000,000 at December 31, 1998 and December 31, 1997. Outstanding borrowings on these lines of credit were $49,021,000 at December 31, 1998. Interest rates on these lines of credit range from the Eurodollar or LIBOR rate plus 2% to the prime rate plus 1.25%. The Company is not required to maintain compensating balances or forward sales commitments under the terms of these lines of credit.

The Company also finances its loan purchases with two revolving line of credit and sale facilities as part of asset backed commercial paper facilities with multi-seller commercial paper issuers. Such facilities totaled $175,000,000 at December 31, 1998 and $150,000,000 at December 31, 1997. As of December 31, 1998 and December 31, 1997, the outstanding balances of loans sold or pledged under these facilities were $148,164,000 and $121,142,000, respectively. There were no outstanding borrowings under these lines of credit at December 31, 1998. Outstanding borrowings under these lines of credit were $169,000 at December 31, 1997. Interest is payable on these lines of credit based on certain commercial paper rates.

In June 1998, the Company issued 1,000,000 shares of common stock at $19 per share. The net proceeds of the offering were $17,717,000 and were used to pay down certain lines of credit. In connection with the underwriters' option to purchase additional shares to cover over-allotments, the Company issued an additional 166,500 shares in July 1998. Net proceeds of these shares totaled $2,990,000 and were also used to pay down certain lines of credit.

The Company also finances its liquidity needs with long-term debt. Long-term debt totaled $134,588,000 at December 31, 1998 and $105,347,000 at December 31, 1997.

In September of 1998, the Company redeemed a term note of $3,265,000 resulting in an extraordinary loss of $77,000, net of applicable tax benefit of $48,000. The note was collateralized by certain of the Company's retained interests in loan sales and cash. The balance outstanding on the note was $5,210,000 at December 31, 1997.

In June 1997, the Company entered into two interest rate swap agreements. The swap agreements involve the payment of interest to the counterparty at the prime rate on a notional amount of $110,000,000 and the receipt of interest at the commercial paper rate plus a spread and the LIBOR rate plus a spread on notional amounts of $80,000,000 and $30,000,000, respectively. The swap agreements expire in June 2000. There is no exchange of the notional amounts upon which interest payments are based.

In June, 1994, the Company entered into an interest rate cap agreement with a bank in order to manage its exposure to certain increases in interest rates. The interest rate cap entitles the Company to receive an amount, based on an amortizing notional amount, which at December 31, 1998 was $3,670,000, when commercial paper rates exceed 8%. If payments were to be received as a result of the cap agreement, they would be accrued as a reduction of interest expense. This agreement expires in July 2003.

Historically, the Company has not required major capital expenditures to support its operations.

Credit Quality and Allowances for Loan Losses

The Company maintains allowances for loan losses and recourse obligations on retained interests in loan sales at levels which, in the opinion of management, provide adequately for current and estimated future losses on such assets. Past-due loans (loans 31 days or more past due which are not covered by dealer/developer reserves and guarantees) as a percentage of the Serviced Portfolio as of December 31, 1998, decreased to 0.95% from 1.20% at December 31, 1997. Management evaluates the adequacy of the allowances on a quarterly basis by examining current delinquencies, the characteristics of the accounts, the value of the underlying collateral, and general economic conditions and trends. Management also evaluates the extent to which dealer/developer reserves and guarantees can be

expected to absorb loan losses. When the Company does not receive guarantees on loan portfolios purchased, it adjusts its purchase price to reflect anticipated losses and its required yield. This purchase adjustment is recorded as an increase in the allowance for loan losses and is used only for the respective portfolio. A provision for loan losses is recorded in an amount deemed sufficient by management to maintain the allowances at adequate levels. Total allowances for loan losses and recourse obligations on retained interests in loan sales increased to $6,707,000 at December 31, 1998 compared to $5,877,000 at December 31, 1997. The allowance ratio (the allowances for loan losses divided by the amount of the Serviced Portfolio) at December 31, 1998 decreased to 1.44% from 1.93% at December 31, 1997 primarily as a result of the increase in Hypothecation Loans as a percentage of the Serviced Portfolio.

As part of the Company's financing of Purchased Loans, arrangements are entered into with dealers and resort developers, whereby reserves are established to protect the Company from potential losses associated with such loans. As part of the Company's agreement with the dealers and resort developers, a portion of the amount payable to each dealer and resort developer for a Purchased Loan is retained by the Company and is available to the Company to absorb loan losses for those loans. The Company negotiates the amount of the reserves with the dealers and developers based upon various criteria, two of which are the financial strength of the dealer or developer and credit risk associated with the loans being purchased. Dealer/developer reserves amounted to $9,979,000 and $10,655,000 at December 31, 1998 and December 31, 1997, respectively. The Company generally returns any excess reserves to the dealer/developer on a quarterly basis as the related loans are repaid by borrowers.

Year 2000 Compliance

Many currently installed computer systems and software products are coded to accept only two-digit entries in the date code field and cannot distinguish 21st century dates from 20th century dates. As a result, many companies' software and computer systems may need to be upgraded or replaced in order to comply with "Year 2000" requirements.

State of Readiness. The year 2000 readiness process consists of the following phases: (i) identification of all IT Systems and non-IT Systems; (ii) assessment of repair or replacement requirements; (iii) repair or replacement; (iv) testing; (v) implementation; and (vi) creation of contingency plans in the event of year 2000 failures. The Company has evaluated the year 2000 readiness of the information technology systems used in its operations ("IT Systems") and its non-IT Systems, such as building security, voice mail and other systems. Non-compliant IT Systems and non-IT Systems are expected to be remediated by the end of the second quarter of 1999.

The Company's current financial and accounting software was installed in October 1998, and the supplier has informed the Company that such software is year 2000 compliant. The Company uses a third party servicer to perform certain functions, such as receipt and posting of loan payments and other loan related activity. The third party servicer has represented to the Company that its systems are year 2000 compliant. In addition, the Company relies upon various vendors, governmental agencies, utility companies, telecommunication service companies, delivery service companies and other service providers who are outside of its control. There is no assurance that such parties will not suffer a year 2000 business disruption, which could have a material adverse effect on the Company's financial condition and results of operations.

During 1998, the Company circulated a questionnaire to vendors and customers with whom the Company has material relationships to obtain information about year 2000 compliance. The Company is still receiving and evaluating this information to identify any significant risks. We plan to require all our business partners to address any significant risks by July 1, 1999. We plan to replace any material non-compliant business partners by October 1, 1999.

Costs. To date, the Company has not incurred any material expenditures in connection with identifying or evaluating year 2000 compliance issues. Most of its expenses have related to the opportunity cost of time spent by employees of the Company evaluating year 2000 compliance matters generally. The Company believes that internally generated funds or available cash should be sufficient to cover the projected costs associated with any modifications to existing software to make it year 2000 compliant. However, no assurances can be given that such modifications can be made in a timely and cost effective manner. Failure to make timely modifications could, in a worse case scenario, result in the inability to process loans and loan related data and could have a material adverse effect on the Company. At this time, the Company does not possess the information necessary to estimate the potential impact of year 2000 compliance issues relating to its other IT-Systems, non-IT

Systems, its vendors, its customers, and other parties. Such impact, including the effect of a year 2000 business disruption, could have a material adverse effect on the Company's financial condition and results of operations.

Contingency Plan. The Company has not yet developed a year 2000-specific contingency plan. If further year 2000 compliance issues are discovered, the Company then will evaluate the need for one or more contingency plans relating to such issues.

Market for Common Stock

The Company's Common Stock is traded on The Nasdaq Stock Market's National Market under the symbol "LTCH." The following table sets forth, for the periods indicated, the high and low stock prices of the Company's Common Stock. All share prices have been adjusted for a 5% stock dividend in 1996.

	High	Low	Dividends
1998			
4th Quarter..........	19 5/8	9 1/4	$.07
3rd Quarter..........	22 3/4	15	--
2nd Quarter..........	24	18 1/4	--
1st Quarter..........	24	17 1/2	--
1997			
4th Quarter..........	21 1/2	16 1/2	$.06
3rd Quarter..........	21 3/4	16 3/8	--
2nd Quarter..........	17	13 7/8	--
1st Quarter..........	16 3/4	14	--
1996			
4th Quarter..........	15	12 1/2	$.05
3rd Quarter..........	15	11 1/2	--
2nd Quarter..........	14 1/4	12 7/8	--
1st Quarter..........	13 5/8	11	--

Inflation

Inflation has not had a significant effect on the Company's operating results to date.

Exposure to Market Risk

The Company performs an interest rate sensitivity analysis to identify the potential interest rate exposures. Specific interest rate risks analyzed include asset/liability mismatches, basis risk, risk caused by floors and caps, duration mismatches and re-pricing lag in response to changes in a base index.

A simulated earnings model is used to identify the impact of specific interest rate movements on earnings per share for the next 12 months. The model incorporates management's expectations about future origination levels, origination mix, amortization rates, prepayment speeds, timing of loan sales, timing of capital issues, extensions and/or increases in lines of credit, pricing of originations and cost of debt and lines of credit.

The Company's objective in managing the interest rate exposures is to maintain, at a reasonable level, the impact on earnings per share of an immediate and sustained change of 100 basis points in interest rates in either direction. The Company periodically reviews the interest rate risk and various options such as capital structuring, product pricing, hedging and spread analysis to manage the interest rate risk at reasonable levels.

As of December 31, 1998, the Company had the following estimated sensitivity profile:

Interest rate changes (in basis points)	100	(100)
Impact on earnings per share	($0.02)	$0.06
Impact on interest income and pre-tax earnings	($136,000)	$425,000

Forward-looking Statements

Except for the historical information contained or incorporated by reference in this annual report, the matters discussed or incorporated by reference herein are forward-looking statements. Such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements of the Company, or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such factors include, among others, the risk factors set forth under "Risk Factors", as listed in the 1998 Form 10-K, as well as the following: general economic and business conditions; industry trends; changes in business strategy or development plans; availability and quality of management; and availability, terms and deployment of capital. Special attention should be paid to such forward-looking statements including, but not limited to, statements relating to (i) the Company's ability to execute its growth strategies and to realize its growth objectives and (ii) the Company's ability to obtain sufficient resources to finance its working capital needs and provide for its known obligations.

LITCHFIELD FINANCIAL CORPORATION
Consolidated Balance Sheets
(In thousands, except share and per share amounts)

	December 31, 1998	1997
ASSETS		
Cash and cash equivalents......................	$ 10,537	$ 19,295
Restricted cash..............................	27,898	23,496
Loans held for sale, net of allowance for loan losses of $549 in 1998 and $1,388 in 1997............	19,750	16,366
Other loans, net of allowance for loan losses of $2,477 in 1998 and $2,044 in 1997..........	191,292	86,307
Retained interests in loan sales, net of estimated recourse obligations $3,681 in 1998 and $2,445 in 1997..........	28,883	30,299
Other..	15,522	11,027
Total assets............................	$293,882	$186,790
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Lines of credit............................	$ 49,021	$ 177
Term note payable and mortgage payable......	1,500	5,210
Accounts payable and accrued liabilities....	8,312	6,479
Dealer/developer reserves..................	9,979	10,655
Deferred income taxes......................	8,388	6,851
Long-term notes............................	134,588	105,347
	211,788	134,719
Stockholders' equity		
Preferred stock, $.01 par value; authorized 1,000,000 shares, none issued and outstanding..	---	---
Common stock, $.01 par value; authorized 12,000,000 shares, 6,886,329 shares issued and outstanding in 1998 and 5,656,609 shares issued and outstanding in 1997	69	56
Additional paid in capital....................	58,040	36,681
Accumulated other comprehensive income.........	1,250	1,071
Retained earnings	22,735	14,263
Total stockholders' equity.................	82,094	52,071
Total liabilities and stockholders' equity..	$293,882	$186,790

See accompanying notes to consolidated financial statements.

LITCHFIELD FINANCIAL CORPORATION
Consolidated Statements of Income
(In thousands, except share and per share amounts)

	Year Ended December 31, 1998	1997	1996
Revenues:			
Interest and fees on loans............	$25,736	$19,374	$14,789
Gain on sale of loans.................	10,691	8,564	7,331
Servicing and other income............	2,379	1,753	1,576
	38,806	29,691	23,696
Expenses:			
Interest Expense......................	14,265	10,675	7,197
Salaries and employee benefits........	4,806	3,399	2,824
Other operating expenses..............	3,834	3,480	3,147
Provision for loan losses.............	1,532	1,400	1,954
	24,437	18,954	15,122
Income before income taxes and extraordinary item....................	14,369	10,737	8,574
Provision for income taxes...............	5,537	4,134	3,301
Income before extraordinary item.........	8,832	6,603	5,273
Extraordinary item (net of tax benefit of $48 and $138 for 1998 and 1997, respectively).........................	(77)	(220)	---

Net Income	$ 8,755	$ 6,383	$ 5,273
Basic per common share amounts:			
Income before extraordinary item	$ 1.41	$ 1.19	$ .97
Extraordinary item	(.01)	(.04)	--
Net income	$ 1.40	$ 1.15	$ .97
Basic weighted average number of shares	6,273,638	5,572,465	5,441,636
Diluted per common share amounts:			
Income before extraordinary item	$ 1.34	$ 1.12	$ .93
Extraordinary item	(.01)	(.04)	--
Net income	$ 1.33	$ 1.08	$ .93
Diluted weighted average number of shares	6,604,367	5,909,432	5,682,152

See accompanying notes to consolidated financial statements.

LITCHFIELD FINANCIAL CORPORATION
Consolidated Statement of Stockholders' Equity
(In thousands, except share and per share amounts)

	Common Stock	Additional Paid In Capital	Accumulated Other Comprehensive Income	Retained Earnings	Treasury Stock	Total
Balance, December 31, 1995	$52	$31,873	$ --	$6,065	$(594)	$37,396
Issuance of 259,124 shares in connection with 5% stock dividend	3	3,301	--	(3,304)	--	--
Issuance of 10,560 shares (including reissuance of 10 shares held in treasury)	--	52	--	--	--	52
Retirement of 48,990 shares held in treasury	(1)	(593)	--	--	594	--
Dividends ($.05 per share)	--	--	--	(273)	--	(273)
Net income	--	--	--	5,273	--	5,273
Balance, December 31, 1996	54	34,633	--	7,761	--	42,448
Issuance of 212,210 shares	2	2,048	--	--	--	2,050
Other comprehensive income	--	--	1,071	--	--	1,071
Tax benefit from stock options exercised	--	--	--	458	--	458
Dividends ($.06 per share)	--	--	--	(339)	--	(339)
Net income	--	--	--	6,383	--	6,383
Balance, December 31, 1997	56	36,681	1,071	14,263	--	52,071
Issuance of 1,229,720 shares	13	21,359	--	--	--	21,372
Other comprehensive income	--	--	179	--	--	179
Tax benefit from stock options exercised	--	--	--	196	--	196
Dividends ($.07 per share)	--	--	--	(479)	--	(479)
Net income	--	--	--	8,755	--	8,755
Balance, December 31, 1998	$69	$58,040	$1,250	$22,735	$ --	$82,094

See accompanying notes to consolidated financial statements.

LITCHFIELD FINANCIAL CORPORATION
Consolidated Statements of Comprehensive Income
(In thousands)

	Year ended December 31, 1998	1997	1996
Net income	$8,755	$6,383	$5,273
Other comprehensive income, net of tax:			
Unrealized gains on retained interests in loan sales (net of taxes of $112 and $670 for 1998 and 1997, respectively)	179	1,071	--
Comprehensive income	$8,934	$7,454	$5,273

See accompanying notes to consolidated financial statements.

LITCHFIELD FINANCIAL CORPORATION
Consolidated Statements of Cash Flows
(In thousands)

	Year Ended December 31, 1998	1997	1996
Cash flows from operating activities:			
Net income	$ 8,755	$ 6,383	$ 5,273
Adjustments to reconcile net income to net cash (used in) provided by operating activities:			
Gain on sale of loans	(10,691)	(8,564)	(7,331)
Amortization and depreciation	1,015	954	520
Amortization of retained interests in loan sales	6,549	4,945	3,444
Provision for loan losses	1,532	1,400	1,954
Deferred income taxes	1,537	1,771	1,340
Net changes in operating assets and liabilities:			
Restricted cash	(4,402)	(4,573)	(2,578)
Loans held for sale	(1,546)	(3,644)	3,008
Retained interests in loan sales	(3,081)	(2,264)	(4,868)
Dealer/developer reserves	(676)	27	984
Net change in other assets and liabilities	(1,192)	1,456	(1,373)
Net cash (used in) provided by operating activities	(2,200)	(2,109)	373
Cash flows from investing activities:			
Net originations, purchases and principal payments on other loans	(188,544)	(54,882)	(47,170)
Other loans sold	83,126	47,727	--
Collections on retained interests in loan sales	6,505	4,620	590
Capital expenditures and other assets	(2,913)	(3,341)	(8)
Net cash used in investing activities	(101,826)	(5,876)	(46,588)
Cash flows from financing activities:			
Net borrowings (payments) on lines of credit	48,844	(36,122)	36,299
Net payments on term note	(3,710)	(2,218)	(2,408)
Net proceeds from long term debt	29,241	58,352	(406)
Net proceeds from issuance of common stock	21,372	2,050	52
Dividends paid	(479)	(339)	(273)
Net cash provided by financing activities	95,268	21,273	33,264
Net (decrease) increase in cash and cash equivalents	(8,758)	13,738	(12,951)
Cash and cash equivalents, beginning of year	19,295	5,557	18,508
Cash and cash equivalents, end of year	$10,537	$19,295	$ 5,557
Supplemental Schedule on Noncash Financing and Investing Activities:			
Exchange of loans for retained interests in loan sales	$ 837	$ 577	$ 3,540
Transfers from loans to real estate acquired through foreclosure	$ 1,817	$ 1,425	$ 1,654
Supplemental Cash Flow Information:			
Interest paid	$13,419	$ 9,841	$ 6,674
Income taxes paid	$ 2,639	$ 2,656	$ 1,411

See accompanying notes to consolidated financial statements.

Exhibit 13.1

LITCHFIELD FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

1. Summary of Significant Accounting Policies

Business

Litchfield Financial Corporation is a diversified finance company that provides financing to creditworthy borrowers for assets not typically financed by banks. The Company provides such financing by purchasing consumer loans and by making loans to businesses secured by consumer receivables or other assets. The Company considers its activities to be one operating segment.

Basis of Presentation

The consolidated financial statements include the accounts of Litchfield Financial Corporation and its majority and wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated upon consolidation.

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

Interest income

Interest income from loans and retained interests in loan sales is recognized using the interest method. Accrual of interest is suspended when collection is doubtful and, in any event, when a loan is contractually delinquent for ninety days. The accrual is resumed when the loan becomes contractually current as to principal and interest and past-due interest is recognized at that time.
Gain on sale of loans and retained interests in loan sales

As of January 1, 1997, the Company adopted the requirements of Statement of Financial Accounting Standards No. 125 "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" for transfers of receivables. In December, 1998, the Financial Accounting Standards Board issued a Special Report "A Guide to Implementation of Statement 125 on Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities - Questions and Answers". As a result, the Company modified its gain-on-sale accounting in the fourth quarter to include, among other things, adoption of a "cash-out" method of accounting. In evaluating the gain-on-sale of prior transactions, the Company determined that the impact of the modifications, including the adoption of the "cash out" method of accounting, to be immaterial.

Gains on sales of loans are based on the difference between the allocated cost basis of the assets sold and the proceeds received, which includes the fair value of any assets or liabilities that are newly created as a result of the transaction. Newly created interests, which consist primarily of interest only strips and recourse obligations, are initially recorded at fair value. The previous carrying amount is allocated between the assets sold and any retained interests based on their relative fair values at the date of transfer. Retained interests in transferred assets consists of subordinate portions of the principal balance of transferred assets and interest only strips.

The Company estimates fair value using discounted cash flow analysis, since quoted market prices are not readily available. The Company's analysis incorporates estimates that market participants would be expected to use in their estimates of future cash flows, including assumptions about interest rates, defaults and prepayment rates. Estimates made are based on, among other things, the Company's past experience with similar types of financial assets. The interest rates paid to investors range from 6.5% to 9.0%. The prepayment rates were 17.5% for Land Loan sales and 18.0% for VOI Loan sales. For the Hypothecation Loan sales, the prepayment rates for the underlying collateral used were 17.5% for Land Loans and 18.0% for VOI Loans. The Company estimates default rates to be 1.9% on Land Loans, 3.0% on VOI Loans and 0.5% on Hypothecation Loans. In valuing its retained interests in loan sales, the Company selects discount rates commensurate with the duration and risks embedded in the particular assets. Specifically, the Company uses discount rates ranging from the investor pass-through rates (for restricted cash) to the Baa corporate bond rate plus 325 basis points (for interest only strips and retained principal certificates) to estimate the fair value of its retained interests.

There is no servicing asset or liability arising from loan sales, because the Company estimates that the benefits of servicing approximate the costs to meet its servicing responsibilities.

On a quarterly basis, the Company assesses the carrying value of retained interest in loans sold by comparing actual and assumed prepayment rates on a disaggregated basis reflecting factors such as origination dates and types of loans. The Company adjusts the carrying value of retained interests for unfavorable changes considered other than temporary.

Loans

Loans held for sale are carried at the lower of aggregate cost or market value. Market value is determined by outstanding commitments from investors or current investor yield requirements.

Provisions for loan losses and impairment of loans

Provisions for loan losses are charged to income in amounts sufficient to maintain the allowances at levels considered adequate to cover anticipated losses on outstanding loans, including loans sold and retained interests in loan sales. Management evaluates allowance requirements on a quarterly basis by examining current delinquencies, historical loan losses, the value of the underlying collateral and general economic conditions and trends. Management also evaluates the availability of dealer/developer reserves to absorb loan losses. The Company determines those loans that are uncollectible based upon detailed review of all loans and any charge-offs are charged to the allowance for loan losses.

Land Loans, VOI Loans and Other Loans which consist of large groups of smaller balance loans are evaluated collectively for impairment and are stated at the lower of cost or fair value.

Hypothecation Loans and A&D Loans are evaluated individually for impairment based on the factors previously described. No such loans were impaired at December 31, 1998 or 1997.

Loan origination fees and related costs

The Company defers the excess of loan origination fees over related direct costs and recognizes such amount as interest income over the estimated life of the related loans using the interest method.

Real estate acquired through foreclosure

Real estate acquired through foreclosure is carried at the lower of fair value less estimated costs to sell or cost. On a quarterly basis, the Company evaluates the carrying value of the real estate and establishes a valuation allowance if the fair value of the asset less the estimated costs to sell the asset is less than the carrying value of the asset. Subsequent increases in the fair value less the estimated cost to sell the asset would reduce the valuation allowance, but not below zero. There was no such valuation allowance at December 31, 1998 or 1997. Other real estate owned of $757,000 and $910,000 is included in other assets at December 31, 1998 and 1997, respectively.

Dealer/developer reserves

As part of the Company's financing of loans through dealer/developers, the Company retains a portion of the proceeds from the purchased loans as a reserve to offset potential losses on those loans. The Company negotiates the amount of reserves with the dealer/developers based upon various criteria, including the credit risk associated with the dealer/developer and the loans being purchased. The Company generally returns any excess reserves to the dealer/developer on a quarterly basis as the related loans are repaid by borrowers.

Income taxes

The Company uses the liability method of accounting for income taxes in its financial statements.

Net income per common share

Basic earnings per share excludes dilution and is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if stock options and stock award grants were exercised.

Cash and cash equivalents

The Company considers all highly liquid instruments purchased with an original maturity of three months or less to be cash equivalents.
Restricted cash

Restricted cash represents accounts established as credit enhancements for certain loan sales and escrow deposits held for customers.

Deferred debt issuance costs

Deferred debt issuance costs are amortized over the life of the related debt. The unamortized balance of $3,883,000 and $3,336,000 is included in other assets at December 31, 1998 and 1997, respectively. The amount of the accumulated amortization was $2,596,000 and $1,868,000 at December 31, 1998 and 1997, respectively.

Stock-based compensation

In October 1995, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123 "Accounting for Stock-Based Compensation." The Company has elected to follow Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" (APB 25) and related Interpretations in accounting for its employee stock options because, as discussed below, the alternative fair value accounting provided for under FASB Statement No. 123, "Accounting for Stock-Based Compensation," requires use of option valuation models that were not developed for use in valuing employee stock options. Under APB 25, because the exercise price of the Company's employee stock options equals the market price of the underlying stock on the date of grant, no compensation expense is recognized.

Reclassification

Certain amounts in the 1996 financial statements have been reclassified to conform with the 1997 and 1998 presentations.

Comprehensive Income

In June 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 130 ("Statement No. 130"), "Reporting Comprehensive Income". Statement No. 130 establishes new rules for the reporting and display of comprehensive income and its components.

Statement No. 130 requires unrealized gains or losses on the Company's available-for-sale securities, previously required to be reported as a separate component of stockholder's equity, to be included in other comprehensive income and the disclosure of accumulated comprehensive income. Statement No. 130 also requires that other comprehensive income items and comprehensive income be displayed separately in the financial statements.

New accounting standards

In June, 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133 ("Statement No. 133"), "Accounting for Derivative Instruments and Hedging Activities." Statement No. 133 is effective for all fiscal quarters of all fiscal years beginning after June 15, 1999, with early adoption permitted as of the beginning of any quarter after the date of issuance. Statement No. 133 establishes accounting and reporting standards for derivative instruments, including certain derivatives embedded in other contracts and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. If certain conditions are met, a derivative may be specifically designated as (a) a hedge of the exposure to changes in the fair value of a recognized asset or liability or an unrecognized firm commitment, (b) a hedge of the exposure to variable cash flows of a forecasted transaction, or (c) a hedge of the foreign currency exposure of a net investment in a foreign operation, an unrecognized firm commitment, an available-for-sale security, or a foreign-currency-denominated forecasted transaction. The accounting for changes in the fair value of a derivative depends on the intended use of the derivative and the resulting designation. The provisions of Statement No. 133 can not be applied retroactively to financial statements of prior periods.

The Company plans to adopt Statement No. 133 in the fiscal quarter beginning January 1, 2000. At the date of initial application, the Company must recognize any freestanding derivative instruments in the balance sheet as either assets or liabilities and measure them at fair value. The Company shall also recognize offsetting gains and losses on hedged assets, liabilities, and firm commitments by adjusting their carrying amounts at that date as a cumulative effect of a change in accounting principal. Whether such transition adjustment is reported in net income, other comprehensive income, or allocated between both is based on the hedging relationships, if any, that existed for that derivative instrument and were the basis for accounting prior to the application of Statement No. 133. (See Note 5 for disclosure of the Company's derivative activity).

2. Investments and Retained Interests in Loan Sales

The following is a summary of investments and retained interests in loan sales:

(Dollars in thousands) December 31, 1998	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Mortgage-backed securities..	$ 44	$ --	$ --	$ 44
Retained interests in loan sales.......................	31,314	1,250	--	32,564
Total.....................	$31,358	$1,250	$ --	$32,608

(Dollars in thousands) December 31, 1997	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Mortgage-backed securities..	$ 83	$ --	$ --	$ 83
Retained interests in loan sales.......................	31,673	1,071	--	32,744
Total......	$31,756	$1,071	$ --	$32,827

The amortized cost and estimated fair value of investments and retained interests in loan sales at December 31, 1998, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because the issuers of the securities may have the right to prepay obligations without prepayment penalties. Mortgage-backed securities are included in other assets.

(Dollars in thousands)	Cost	Estimated Fair Value
Due in one year or less.........	$ 9,760	$ 9,760
Due after one year through years...........................	21,598	22,848
Total debt securities.........	$31,358	$32,608

In 1990, the Company began privately placing issues of pass-through certificates evidencing an undivided beneficial ownership interest in pools of loans which have been transferred to trusts. The principal and part of the interest payments on the loans transferred to the trust are collected by the Company, as the servicer of the loan pool, remitted to the trust for the benefit of the investors, and then distributed by the trust to the investors in the pass-through certificates.

In certain of the Company's issues of pass-through certificates, credit enhancement was achieved by dividing the issue into a senior portion which was sold to the investors and a subordinated portion which was retained by the Company. The Company had investments in pass-through certificates of $12,323,000 and $15,747,000 at December 31, 1998 and 1997, respectively. In certain other of the Company's private placements, credit enhancement was achieved through cash collateral. The Company had $25,685,000 and $21,412,000 of restricted cash at December 31, 1998 and 1997, respectively, representing credit enhancements.

If borrowers default in the payment of principal or interest on the mortgage loans underlying these issues of pass-through certificates, losses would be absorbed first by the subordinated portion or cash collateral account retained by the Company and might, therefore, have to be charged against the estimated recourse obligations to the extent dealer/developer guarantees and reserves are not available.

3. Loans

Loans at December 31 consisted of the following:

(Dollars in thousands)	December 31,	
Loans held for sale	1998	1997
Land............	$ 4,729	$10,333
VOI.............	1,203	3,134
Other...........	14,531	4,520
Discount, net...	(164)	(233)
Allowance for loan losses......	(549)	(1,388)
Loans, net......	$19,750	$16,366

(Dollars in thousands)	December 31,	
Other loans	1998	1997
Land....................	$ 2,307	$ 1,911
VOI.....................	569	793
Hypothecation...........	69,815	36,206
A&D.....................	51,986	41,385
Tax Liens...............	21,228	---
Builder Construction.....	33,867	---
Other...................	14,078	8,631
Discount, net...........	(81)	(575)
Allowance for loan losses	(2,477)	(2,044)
Loans, net.............	$191,292	$86,307

Contractual maturities of loans as of December 31, 1998 are as follows:

(Dollars in thousands)	December 31, 1998
1999.................	55,726
2000.................	5,716
2001.................	16,925
2002.................	53,035
Thereafter...........	82,911
	$214,313

It is the Company's experience that a substantial portion of the loans will be repaid before contractual maturity dates. Consequently, the above tabulation is not to be regarded as a forecast of future cash collections.

4. Allowances for Loan Losses and Estimated Recourse Obligations

An analysis of the total allowances for all loan losses and recourse obligations follows:

(Dollars in thousands)	December 31, 1998	December 31, 1997
Allowance for losses on loans held for sale...........	$ 549	$1,388
Allowance for losses on other loans....................	2,477	2,044
Estimated recourse obligation on retained interests in loan sales....................	3,681	2,445
	$6,707	$5,877

The total allowance for loan losses consists of the following:

(Dollars in thousands)	Year ended December 31, 1998	1997	1996
Allowance at beginning of period............	$5,877	$4,528	$3,715
Net charge-offs of uncollectible accounts..............	(2,239)	(2,010)	(1,965)

Provision for loan losses	1,532	1,400	1,954
Allocation of purchase adjustment (1)......	1,537	1,959	824
Allowance at end of period...........	$6,707	$5,877	$4,528

(1) Represents allocation of purchase adjustment related to the purchase of certain nonguaranteed loans.

Net charge-offs by major loan and collateral types experienced by the Company are summarized as follows:

	Year ended December 31,		
(Dollars in thousands)	1998	1997	1996
Land..................	$ 1,358	$ 986	$ 669
VOI...................	556	939	1,284
Hypothecation.........	---	---	---
A&D...................	---	(2)	(8)
Other.................	325	87	20
Total.................	$2,239	$2,010	$1,965

5. Derivative Financial Instruments Held for Purposes Other than Trading

In June 1997, the Company entered into two interest rate swap agreements in order to manage its basis exposures. The swap agreements involve the payment of interest to the counterparty at the prime rate on a notional amount of $110,000,000 and the receipt of interest at the commercial paper rate plus a spread of 277 basis points on a notional amount of $80,000,000 and the LIBOR rate plus a spread of 267 basis points on notional amount of $30,000,000. The swap agreements expire in June 2000. There is no exchange of the notional amounts upon which the interest payments are based.

The differential to be paid or received as interest rates change is accrued and recognized as an adjustment to interest income from the excess servicing asset. The related amount receivable from or payable to the counterparty is included in other assets or other liabilities. The fair values of the swap agreements are not recognized in the financial statements. The Company intends to keep the contracts in effect until they mature in June 2000.

In June 1994, the Company entered into an interest rate cap agreement with a bank in order to manage its exposure to certain increases in interest rates. The interest rate cap entitles the Company to receive payments, based on an amortizing notional amount, when commercial paper rates exceed 8.0%. If payments were to be received as a result of the cap agreement, they would be accrued as a reduction of interest expense. The notional amount outstanding at December 31, 1998 was $3,670,000. This agreement expires in July 2005.

The Company is exposed to credit loss in the event of non-performance by the swap counterparty or the cap provider.

6. Debt

Financial data relating to the Company's secured lines of credit is as follows:

	December 31,	
(Dollars in thousands)	1998	1997
Lines of credit available (1)..	$116,000	$116,169
Borrowings outstanding at end of year (1)..................	$ 49,021	$ 169
Weighted average interest rate at end of year...............	7.6%	7.7%
Maximum borrowings outstanding at any month end.............	$ 73,666	$ 50,577
Average amount outstanding during the year..............	$ 37,485	$ 33,419
Weighted average interest rate during the year (determined by dividing interest expense by average borrowings)........	7.9%	8.2%

(1) Amount includes $169 of outstanding borrowings at December 31, 1997 on the revolving line of credit with multi-seller commercial paper issuer. (See Note 11.) Amount does not include $1,500 construction mortgage.

In January 1999, the Company amended a secured line of credit to increase the line from $50,000,000 to $60,000,000. Outstanding borrowings under the line of credit at December 31, 1998 were $39,700,000. There were no outstanding borrowings under this line of credit at December

31, 1997. This line of credit is secured by consumer receivables and other secured loans and matures in April 2000.

In December 1997, the Company amended a line of credit to increase the line from $20,000,000 to $30,000,000. There were no outstanding borrowings under this facility at December 31, 1998 and 1997. This facility is secured by certain retained interests in loan sales, cash collateral accounts and certain other loans and matures in September 1999.

In March 1997, the Company entered into a $25,000,000 secured line of credit. Outstanding borrowings under the line of credit at December 31, 1998 were $9,321,000. There were no outstanding borrowings at December 31, 1997. The facility is secured by loans to developers of VOI resorts, popularly known as timeshare resorts, for the acquisition and development of VOI resorts ("Facility A") and the related financing of consumer purchases of VOIs ("Facility B"). Although the maximum amount that can be borrowed on each facility is $15,000,000, the aggregate outstanding borrowings cannot exceed $25,000,000. This facility expires in March 2000.

In January 1997, the Company amended a line of credit to increase the line from $5,000,000 to $8,000,000. This line of credit is secured by consumer receivables and other secured loans and matures in March 1999. There were no outstanding borrowings on this line of credit at December 31, 1998 and 1997.

In March 1998, the Company renewed an additional $3,000,000 line of credit, secured by consumer receivables and other secured loans. This line of credit matures in March 1999. There were no outstanding borrowings at December 31, 1998 and 1997.

Also in March 1998, the Company amended the $1,500,000 construction mortgage, secured by certain assets of the Company, extending the maturity date to March 2009. Outstanding borrowings under this construction mortgage were $1,500,000 and $8,000 at December 31, 1998 and 1997, respectively.

Interest rates on the above lines of credit range from the Eurodollar or LIBOR rate plus 2% to the prime rate plus 1.25%. The Company is not required to maintain compensating balances or forward sales commitments under the terms of these lines of credit.

In September 1998, the Company redeemed a term note of $3,265,000 resulting in an extraordinary loss of $77,000, net of applicable tax benefit of $48,000. The note was collateralized by certain of the Company's retained interests in loan sales and cash. The balance outstanding on the note was $5,210,000 at December 31, 1997.

As of December 31, 1998 and 1997 the Company had no unsecured lines of credit.

Financial data relating to the Company's long-term notes is as follows:

	December 31,	
(Dollars in thousands)	1998	1997
9.3% Notes............	$ 20,000	$ 20,000
8.45% Notes due 2002..................	51,282	51,750
8.875% Notes due 2003..................	15,066	15,317
8.25% Notes due 2003..................	10,000	---
9.25% Notes due 2004..................	20,000	---
10% Notes due 2004.....	18,240	18,280
	$134,588	$105,347

The long-term notes are unsecured obligations of the Company and each issuance, except the 9.3% Notes, allows for a maximum annual redemption by noteholders of 5% of the original principal amount thereof. Interest is payable monthly in arrears on each of the issuances, except the 9.3% Notes.

The 9.3% Notes require principal reductions of $7,500,000, $6,000,000, $6,000,000 and $500,000 in March 2001, 2002, 2003 and 2004, respectively. Interest is payable semiannually in arrears.

The Company shall have the option to redeem all or any portion of the long-term notes at predetermined redemption prices. The earliest call date of each issuance is as follows:

9.3% Notes..............	April 1998
8.45% Notes due 2002.....	November 1999
8.875% Notes due 2003....	June 1996
8.25% Notes due 2003.....	November 2000
9.25% Notes due 2004.....	December 2000
10% Notes due 2004.......	April 1998

7. Retirement Plans

The Company has implemented the Litchfield Financial Corporation Employee 401(k) Plan ("the Plan"), a defined contribution plan for all eligible employees at least 21 years of age and who have been employed by the Company for at least six months. Participating employees may elect to defer up to fifteen percent of their annual gross earnings. The Company will match an amount equal to one hundred percent of the employee's pretax contributions up to five percent of the employee's eligible compensation contributed into the Plan. Contributions made by the Company in 1998 and 1997 were $157,000 and $125,000, respectively.

8. Income Taxes

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax assets and liabilities are as follows:

	December 31,	
(Dollars in thousands)	1998	1997
Deferred Tax Assets:		
Loan loss allowance....	$ 244	$ 44
Other..................	656	697
Total deferred tax assets...................	900	741
Valuation allowance..	---	---
Net deferred tax assets.............	900	741
Deferred Tax Liabilities:		
Depreciation...........	42	50
Mortgage loan income recognition..........	7,265	6,131
Accretion income.......	1,696	1,360
Other..................	285	51
Tax deferred tax liabilities.........	9,288	7,592
Net deferred tax liabilities.......	$8,388	$6,851

Significant components of the provision for income taxes attributable to continuing operations are as follow:

	Year ended December 31,		
(Dollars in thousands)	1998	1997	1996
Current:			
Federal.............	$3,196	$2,313	$1,911
State...............	804	50	50
Total Current.....	4,000	2,363	1,961
Deferred:			
Federal.............	1,214	1,630	1,288
State...............	323	141	52
Total Deferred....	1,537	1,771	1,340
	$5,537	$4,134	$3,301

The reconciliation of income tax attributable to continuing operations computed at the U.S. federal statutory tax rates to income tax expense is:

	1998	1997	1996
Tax at U.S. statutory rates....	35.0%	35.0%	35.0%
State income taxes, net of federal tax benefit..........	3.4	3.4	3.4
Other - net....................	0.1	0.1	0.1
	38.5%	38.5%	38.5%

9. Earnings per Share

The following table sets forth the computation of basic and diluted earnings per share:

	1998	1997	1996
Numerator:			
Net income...........	$8,755,000	$6,383,000	$5,273,000
Denominator:			
Denominator for basic earnings per share weighted-average share	6,273,638	5,572,465	5,441,636
Effect of dilutive securities:			
Employee stock options............	330,729	336,967	240,516
Denominator for diluted			

earnings per share-adjusted weighted-average shares and assumed conversions.......	6,604,367	5,909,432	5,682,152
Basic earnings per share..	$1.40	$1.15	$ .97
Diluted earnings per share..	$1.33	$1.08	$ .93

10. Stockholders' Equity and Stock Option Plans

Stockholders' Equity

The Company declared a 5% stock dividend in 1996. Accordingly, weighted average share and per share amounts have been restated for that period.

Stock Option Plans

The Company has reserved 1,422,319 shares of common stock for issuance to officers, directors and employees on exercise of options granted under a stock option plan established in 1990. Options were granted at prices equal to or in excess of the fair market value of the stock on the date of the grant. There were 634,015, 573,346 and 615,000 shares exercisable at December 31, 1998, 1997 and 1996, respectively.

Information with respect to options granted under this plan is as follows:

	Number of Shares	Exercise Price Per Share
Outstanding at December 31, 1995	715,672	
Granted...........	204,311	$11.55 - $14.05
Canceled or exercised..........	(13,175)	$1.15 - $11.55
Outstanding at December 31, 1996	906,808	
Granted...........	46,250	$14.38 - $21.00
Canceled or exercised..........	(209,950)	$4.61 - $13.33
Outstanding at December 31, 1997	743,108	
Granted...........	159,952	$12.69 - $23.25
Canceled or exercised..........	(68,074)	$4.75 - $21.00
Outstanding at December 31, 1998	834,986	

In 1995, the Company established the Stock Option Plan for Non-Employee Directors. Options were granted at prices equal to or in excess of the fair market value of the stock on the date of the grant. There were 12,864, 11,025 and 7,352 options that were exercisable at December 31, 1998, 1997 and 1996, respectively.

Information with respect to options granted under this plan is as follows:

	Number of Shares	Exercise Price Per Share
Outstanding at December 31, 1995	22,052	$12.02
Granted...........	--	--
Canceled or exercised..	--	--
Outstanding at December 31, 1996	22,052	
Granted...........	--	--
Canceled or exercised..	(3,675)	$12.02
Outstanding at December 31, 1997	18,377	
Granted.......	6,000	$22.00
Canceled or exercised..	(5,513)	$12.02
Outstanding at December 31, 1998	18,864	

Pro forma information regarding net income and earnings per share is required by Statement of Financial Accounting Standards No. 123 "Accounting for Stock-based Compensation," which also requires that the information be determined as if the Company had accounted for its employee stock options granted subsequent to December 31, 1994 under the fair value method of that Statement. The fair value for these options was estimated at the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions for 1998, 1997 and 1996, respectively: risk-free interest rates of 4.67%, 5.78% and 6.23%; a dividend yield of .35%, .32% and .35%, volatility factors of the expected market price of the Company's common stock of .26, .23 and .24; and a weighted-average expected life of the option of 7.5 years.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period. The Company's pro forma information that follows is presented in thousands, except per share data.

	Year ended December 31, 1998	1997	1996
Pro forma net income before extraordinary item..	$8,495	$6,280	$4,983
Extraordinary item	(77)	(220)	--
Pro forma net income.....	$8,418	$6,060	$4,983
Pro forma basic earnings per share:			
Income before extraordinary item ...	$ 1.35	$1.13	$ .92
Extraordinary item.....	(.01)	(.04)	--
Net income.....	$ 1.34	1.09	.92
Pro forma diluted earnings per share:			
Income before extraordinary item	$ 1.29	$1.06	$ .88
Extraordinary item.......	(.01)	(.04)	--
Net income.....	$ 1.28	1.02	$ .88

11.Sale of Loans

The Company has sold $492,960,000 and $348,198,000 of loans at face value through December 31, 1998 and 1997, respectively. The principal amount remaining on the loans sold was $238,132,000 and $179,790,000 at December 31, 1998 and 1997, respectively. The Company guarantees, through replacement or repayment, loans in default up to a specific percentage of loans sold. Dealer/Developer guaranteed loans are secured by repurchase or replacement guarantees in addition to, in most instances, dealer/developer reserves.

The Company's exposure to loss on loans sold in the event of nonperformance by the consumer, the dealer/developer on its guarantee, and the determination that the collateral is of no value was $12,750,000, $9,238,000, and $8,780,000 at December 31, 1998, 1997 and 1996, respectively. Such amounts have not been discounted. The Company repurchased $491,000, $740,000 and $991,000 of loans under the recourse provisions of loan sales in 1998, 1997, and 1996, respectively. In addition, when the Company sells loans through securitization programs, the Company commits either to replace or repurchase any loans that do not conform to the requirements thereof in the operative loan sale document.

The Company's Serviced Portfolio is geographically diversified with collateral and consumers located in 46 and 50 states, respectively. At December 31, 1998, 14.7%, 10.3% and 10.2% of the portfolio by collateral location was located in Texas, Florida and California, respectively, and 16.1% and 14.4% of the portfolio by borrower location were located in Florida and Texas, respectively. No other state accounted for more than 7.7% of the total.

The Company has a revolving line of credit and sale facility as part of an asset backed commercial paper facility with a multi-seller commercial paper issuer ("Conduit A"). In June 1998, the Company amended the facility to increase the facility to $150,000,000, subject to certain terms and conditions. The facility expires in June 2001.

In connection with the facility, the Company formed a wholly owned subsidiary, Litchfield Mortgage Securities Corporation 1994, to purchase loans from the Company. In October 1998, Litchfield Mortgage Securities Corporation 1994 was merged with and into Litchfield Mortgage Securities Company 1994, LLC ("LMSC"). LMSC either pledges the loans on a revolving line of credit with Conduit A or sells the loans to Conduit
A. Conduit A issues commercial paper or other indebtedness to fund the purchase or pledge of loans from LMSC. Conduit A is not affiliated with the Company or its affiliates. As of December 31, 1998, the outstanding balance of the sold or pledged loans securing this facility was $137,532,000. There were no outstanding borrowings under the line of credit at December 31, 1998. Outstanding borrowings under the line of credit at December 31, 1997 were $169,000. Interest is payable on the line of credit at an interest rate based on certain commercial paper rates.

In March 1997, the Company closed an additional revolving line of credit and sale facility of $25,000,000 with another multi-seller of commercial paper conduit ("Conduit B"). The facility, which expires in March 2000, is subject to certain terms and conditions, credit enhancement requirements and loan eligibility criteria. The outstanding aggregate balance of the loans pledged and sold under the facility at any time cannot exceed $25,000,000.

In connection with the facility, the Company formed a wholly owned subsidiary, Litchfield Capital Corporation 1996, to purchase loans from the Company. In October 1998, Litchfield Capital Corporation 1996, was merged with and into Litchfield Capital Company 1996, LLC ("LCC"). LCC either pledges the loans on a revolving line of credit with Conduit B or sells the loans to Conduit B. Conduit B issues commercial paper or other indebtedness to fund the purchase or pledge of loans from LCC. Conduit B is not affiliated with the Company or its affiliates. As of December 31, 1998, the outstanding aggregate balance of the sold loans under the facility was $10,632,000. There were no outstanding borrowings under the line of credit as of December 31, 1998 and 1997. Interest is payable on the line of credit at an interest rate based on certain commercial paper rates.

12. Quarterly Results of Operations (Unaudited)

(In thousands, except share and per share) share data)

	First	Second	Third	Fourth	Total
1996					
Total revenues................	$4,650	$6,101	$6,977	$5,968	$23,696
Total expenses................	3,355	3,560	3,808	4,399	15,122
Net Income.................... .	798	1,564	1,946	965	5,273
Earnings per common share:					
Basic........................	.15	.29	.36	.18	.97
Diluted......................	.14	.27	.34	.17	.93
Weighted average number of shares:					
Basic.......................	5,436,149	5,442,768	5,443,319	5,444,399	5,441,636
Diluted.....................	5,629,983	5,708,164	5,697,100	5,706,061	5,682,152
1997					
Total revenues..................	$6,407	$7,691	$8,263	$7,330	$29,691
Total expenses..................	4,545	4,634	4,749	5,026	18,954
Income before extraordinary item	1,145	1,880	2,161	1,417	6,603
Extraordinary item.............	--	--	--	(220)	(220)
Net Income......................	1,145	1,880	2,161	1,197	6,383
Earnings per common share:					
Basic income before . extraordinary item..........	.21	.34	.38	.25	1.19
Diluted income before extraordinary item............	.20	.32	.36	.24	1.12
Extraordinary item............	--	--	--	(.04)	(.04)
Basic net income..............	.21	.34	.38	.21	1.15
Diluted net income............	.20	.32	.36	.20	1.08
Weighted average number of shares:					
Basic.......................	5,446,679	5,560,167	5,629,644	5,652,424	5,572,465
Diluted....................	5,792,078	5,857,176	5,980,698	6,014,831	5,909,432
1998					
Total revenues..................	$7,953	$9,973	$10,465	$10,415	$38,806
Total expenses..................	5,433	6,218	5,966	6,820	24,437
Income before extraordinary item	1,550	2,309	2,767	2,206	8,832
Extraordinary item.............	--	--	(77)	--	(77)
Net Income......................	1,550	2,309	2,690	2,206	8,755
Earnings per common share:					
Basic income before extraordinary item.............	.27	.40	.40	.32	1.41
Diluted income before extraordinary item.............	.26	.38	.39	.31	1.34
Extraordinary item............	--	--	(.01)	--	(.01)
Basic net income..............	.27	.40	.39	.32	1.40
Diluted net income............	.26	.38	.38	.31	1.33
Weighted average number of shares:					
Basic.......................	5,659,756	5,754,018	6,835,775	6,845,004	6,273,638
Diluted....................	6,020,158	6,117,832	7,158,882	7,120,202	6,604,367

A significant portion of the Company's revenues consists of gains on sales of loans. Thus, the timing of loan sales has a significant effect on the Company's results of operations.

Exhibit 13.1

REPORT OF MANAGEMENT

Exhibit 13.1

To the Stockholders and Noteholders of
LITCHFIELD FINANCIAL CORPORATION

The accompanying consolidated financial statements have been prepared in conformity with generally accepted accounting principles. They include amounts based on informed judgment and estimates. The representations in the financial statements are the responsibility of management. Financial information elsewhere in the Annual Report is consistent with that in the financial statements.

To meet management's responsibility, the Company maintains a system of internal control designed to provide reasonable assurance that errors or irregularities that could be material to the financial statements are prevented or would be detected within a timely period. The system of internal control includes statements of policies and business practices, widely communicated to employees, which are designed to require them to maintain high ethical standards in their conduct of Company affairs. The internal controls are augmented by organizational arrangements that provide for appropriate delegation of authority and division of responsibility and by a program of internal audit with management follow-up.

The financial statements have been audited by Ernst & Young LLP. Their audit was conducted in accordance with generally accepted auditing standards and included a review of internal controls and selective tests of transactions.

The Audit Committee of the Board of Directors, composed entirely of outside directors, meets periodically with the independent auditors and management to review accounting, auditing, internal accounting controls and financial reporting matters. The independent auditors have free access to this committee without management present.

/s/ Ronald E. Rabidou

RONALD E. RABIDOU
Executive Vice President,
Chief Financial Officer and Treasurer

/s/ David M. Pascale

DAVID M. PASCALE
Chief Accounting Officer,
Vice President and Controller

REPORT OF INDEPENDENT AUDITORS

The Board of Directors and Stockholders

LITCHFIELD FINANCIAL CORPORATION

We have audited the accompanying consolidated balance sheets of Litchfield Financial Corporation as of December 31, 1998 and 1997, and the related consolidated statements of income, changes in stockholders' equity, comprehensive income and cash flows for each of the three years in the period ended December 31, 1998. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Litchfield Financial Corporation at December 31, 1998 and 1997, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 1998, in conformity with generally accepted accounting principles.

/s/Ernst & Young LLP

ERNST & YOUNG LLP
Boston, Massachusetts
January 30, 1999

Corporate Officers

Richard A. Stratton
Chief Executive Officer and President

Heather A. Sica
Executive Vice President

Ronald E. Rabidou
Executive Vice President,
Chief Financial Officer and Treasurer

Joseph S. Weingarten
Executive Vice President

Wayne M. Greenholtz
Senior Vice President

John J. Malloy
Senior Vice President,
General Counsel and Clerk

James H. Shippee
Senior Vice President

James A. Yearwood
Senior Vice President

David M. Pascale
Chief Accounting Officer,
Vice President and Controller

Counsel

Hutchins, Wheeler & Dittmar,
A Professional Corporation
Boston, MA

Transfer Agent

State Street Bank and Trust Company
c/o Boston EquiServe
Boston, MA

Independent Auditors

Ernst & Young LLP
Boston, MA

Board of Directors

John A. Costa
Managing Director of Planning and Business Development for Cardholder Management Services

Gerald Segel
Retired Chairman, Tucker, Anthony & R.L. Day, Inc.

Heather A. Sica
Executive Vice President

Richard A. Stratton
Chief Executive Officer and President

James Westra, Esq.
Stockholder of Hutchins, Wheeler & Dittmar, A Professional Corporation

Nasdaq Symbol

The common stock is traded under the symbol "LTCH".

Copies of the Company's Form 10-K Report, filed with the Securities and Exchange Commission, may be obtained from the office of the Treasurer, Litchfield Financial Corporation, 430 Main Street, Williamstown, MA 01267.

As of January 31, 1999, there were 1,084 stockholders of record.

Corporate Headquarters

Litchfield Financial Corporation

430 Main Street
Williamstown, MA 01267

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E-mail:lfc@ltchfld.com

Western Regional Office

Litchfield Financial Corporation

13701 West Jewell Avenue

Suite 200
Lakewood, CO 80228

Tel: (303) 985-1030
Fax: (303) 985-5375

SIGNATURES

Pursuant to the requirements of Sections 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

LITCHFIELD FINANCIAL CORPORATION

/s/ David M. Pascale

DAVID M. PASCALE
Chief Accounting Officer, Vice President and Controller
May 4, 1999
