

Accredited Mortgage Loan REIT Trust  
Form 10-Q  
September 18, 2007  
Table of Contents

---

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

---

**FORM 10-Q**

---

(Mark One)

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

For the quarterly period ended March 31, 2007

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 001-32276

---

**ACCREDITED MORTGAGE LOAN REIT TRUST**

(Exact name of registrant as specified in its charter)

---

Maryland  
(State or other jurisdiction of  
incorporation or organization)

15253 Avenue of Science

San Diego, California 92128

35-2231035  
(I.R.S. Employer  
Identification No.)

Edgar Filing: Accredited Mortgage Loan REIT Trust - Form 10-Q

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: 858-676-2100

---

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

Title of each class	Name of each exchange on which registered
9.75% Series A Perpetual Cumulative Preferred Shares	New York Stock Exchange (the NYSE )

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

---

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  or No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

The number of outstanding shares of the registrant's common stock as of August 31, 2007 was 100,000.

(1) See explanatory note.

---

**Table of Contents**

**This Page Intentionally Left Blank**

**Table of Contents**

**EXPLANATORY NOTE**

Accredited Mortgage Loan REIT Trust (the REIT) is an indirect subsidiary of Accredited Home Lenders Holding Co. (Accredited), a company that files annual, quarterly and other reports with the Securities and Exchange Commission (the SEC) pursuant to the Securities Exchange Act of 1934, as amended (the Exchange Act). All of the REIT's outstanding common shares are owned by Accredited Home Lenders, Inc., a wholly-owned subsidiary of Accredited (AHL). As of the date of this report, the only publicly traded securities of the REIT are the REIT's 9.75% Series A Perpetual Cumulative Preferred Shares, payments in respect of which are fully and unconditionally guaranteed by Accredited. In reliance on Rule 12h-5 under the Exchange Act, the REIT did not file reports pursuant to the Exchange Act prior to March 2006. In connection therewith and in accordance with Rule 3-10 of Regulation S-X under the Exchange Act, Accredited has been disclosing certain financial information regarding the REIT in the notes to the consolidated financial statements of Accredited contained in Accredited's reports filed under the Exchange Act. In addition, pursuant to the terms of the REIT's outstanding preferred shares and Accredited's related guarantee of those securities, Accredited has also been disclosing certain additional information regarding the REIT in Accredited's Exchange Act reports.

**Table of Contents**

**TABLE OF CONTENTS**

	<b>Page</b>
<b><u>PART I</u></b>	
Item 1. <u>Financial Statements of Accredited Mortgage Loan REIT Trust</u>	6
<u>Balance Sheets as of March 31, 2007 and December 31, 2006</u>	6
<u>Statements of Operations for the Three Months Ended March 31, 2007 and 2006</u>	7
<u>Statements of Cash Flows for the Three Months Ended March 31, 2007 and 2006</u>	8
<u>Notes to Unaudited Financial Statements</u>	9
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	20
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	41
Item 4. <u>Controls and Procedures</u>	41
<b><u>PART II</u></b>	
Item 1. <u>Legal Proceedings</u>	42
Item 1A. <u>Risk Factors</u>	42
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	42
Item 3. <u>Defaults Upon Senior Securities</u>	42
Item 4. <u>Submission of Matters to a Vote of Security Holders</u>	42
Item 5. <u>Other Information</u>	42
Item 6. <u>Exhibits</u>	42
<u>Signatures</u>	43
<u>Exhibit Index</u>	44
Certifications	

**Table of Contents**

**FORWARD-LOOKING STATEMENTS**

This report contains certain forward-looking statements. When used in this report, statements which are not historical in nature, including the words anticipate, estimate, should, expect, believe, intend and similar expressions are intended to identify forward-looking statements. These statements include statements containing a projection of revenues, earnings or losses, capital expenditures, dividends, capital structure or other financial terms.

The forward-looking statements in this report are based upon our management's beliefs, assumptions and expectations of our future operations and economic performance, taking into account the information currently available to them. These statements are not statements of historical fact. Forward-looking statements involve risks and uncertainties, some of which are not currently known to us, that may cause our actual results, performance or financial condition to be materially different from the expectations of future results, performance or financial condition we express or imply in any forward-looking statements. Some of the important factors that could cause our actual results, performance or financial condition to differ materially from expectations are:

a change in the financial stability of Accredited, which guarantees the dividend payments on our 9.75% Series A Perpetual Cumulative Preferred Shares ( "Series A Preferred Shares" );

an increase in mortgage loan payment default rates due to a general deterioration in economic or political conditions, fluctuations in the real estate markets, an increase in unemployment rates, and/or an increase in interest rates that results in higher mortgage loan payment amounts for the borrower;

a decline in interest income due to a decrease in the difference between our cost of capital and the income generated by payments on our securitized mortgage loan pools;

changes in demand for mortgage backed securities that affect our ability to issue notes to fund our securitizations;

our ability to protect and hedge our mortgage loan portfolio against adverse interest rate movements;

our ability to maintain status as a real estate investment trust and the corresponding tax treatment;

the degree and nature of AHL's competition that may impact the value of the mortgage loans originated by AHL;

an increase in the rate of prepayments on securitized mortgage loans that could reduce the amount of cash flow distributed to us in respect of excess interest;

our ability to accurately make estimates about matters that are inherently uncertain under our critical accounting policies; and

the other factors referenced in this report, including, without limitation, under the sections entitled "ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations."

We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. In light of these risks, uncertainties and assumptions, the forward-looking events discussed in this report might not occur. We qualify any and all of our forward-looking statements entirely by these cautionary factors.



**Table of Contents****PART I****ITEM 1. Financial Statements****ACCREDITED MORTGAGE LOAN REIT TRUST****BALANCE SHEETS**

(in thousands, except share data)

	March 31, 2007 (Unaudited)	December 31, 2006
<b>ASSETS</b>		
Cash and cash equivalents	\$ 59,204	\$ 23,299
Accrued interest receivable	44,603	52,708
Mortgage loans held for investment, net of allowance of \$133,716 and \$129,936, respectively	7,313,720	7,271,553
Derivative assets, including margin account	21,377	64,665
Real estate owned, net	93,843	65,854
Prepaid expenses and other assets	37,692	24,707
Receivable from parent	200,525	112,419
<b>Total assets</b>	<b>\$ 7,770,964</b>	<b>\$ 7,615,205</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>LIABILITIES:</b>		
Securitization and other financing	\$ 7,463,544	\$ 7,289,209
Accrued expenses and other liabilities	37,117	57,507
<b>Total liabilities</b>	<b>7,500,661</b>	<b>7,346,716</b>
<b>COMMITMENTS AND CONTINGENCIES (Note 12)</b>		
<b>STOCKHOLDERS EQUITY:</b>		
Preferred stock, \$1.00 par value; authorized 200,000,000 shares; 4,093,678 shares designated, issued and outstanding as 9.75% Series A Perpetual Cumulative Preferred Shares with an aggregate liquidation preference of \$102,342 at March 31 2007 and December 31, 2006	4,094	4,094
Common stock, \$0.001 par value; authorized 100,000,000 shares; issued and outstanding 100,000 shares	1	1
Additional paid-in capital	397,884	398,628
Accumulated other comprehensive income (loss)	(12,983)	7,947
Accumulated deficit	(118,693)	(142,181)
<b>Total stockholders equity</b>	<b>270,303</b>	<b>268,489</b>
<b>Total liabilities and stockholders equity</b>	<b>\$ 7,770,964</b>	<b>\$ 7,615,205</b>

The accompanying notes are an integral part of these financial statements.



**Table of Contents****ACCREDITED MORTGAGE LOAN REIT TRUST****STATEMENTS OF OPERATIONS****(in thousands, except per share amounts) (Unaudited)**

	<b>Three Months Ended March 31,</b>	
	<b>2007</b>	<b>2006</b>
<b>REVENUES:</b>		
Interest income (including \$2,353 and \$1,588 from parent)	\$ 149,708	\$ 125,719
Interest expense	(99,466)	(71,476)
Net interest income	50,242	54,243
Provision for losses on mortgage loans held for investment	(14,589)	(6,370)
Net interest income after provision	35,653	47,873
Other income	430	688
Total net revenues	36,083	48,561
<b>OPERATING EXPENSES:</b>		
Management fee assessed by parent	9,806	7,800
Direct general and administrative expenses	294	9
Total operating expenses	10,100	7,809
Net income	25,983	40,752
Dividends on preferred stock	(2,495)	(2,495)
Net income available to common stockholders	\$ 23,488	\$ 38,257
Basic and diluted earnings per common share	\$ 234.88	\$ 382.57
Weighted average shares outstanding for basic and diluted	100	100

The accompanying notes are an integral part of these financial statements.

**Table of Contents****ACCREDITED MORTGAGE LOAN REIT TRUST****STATEMENTS OF CASH FLOWS****(In thousands) (Unaudited)**

	<b>Three Months Ended March 31,</b>	
	<b>2007</b>	<b>2006</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 25,983	\$ 40,752
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of net deferred origination fees on securitized mortgage loans	(2,583)	(967)
Amortization of deferred costs	3,091	3,365
Provision for losses on mortgage loans held for investment	14,589	6,370
Unrealized (gain) loss on derivatives	(22,931)	5,210
Adjustment into earnings for gain on derivatives from other comprehensive income	(6,354)	(6,887)
Changes in operating assets and liabilities:		
Accrued interest receivable	8,105	(3,932)
Derivative assets, including margin account	50,115	(2,748)
Prepaid expenses and other assets	(18,699)	(3,112)
Accrued expense and other liabilities	(26,036)	4,351
Net cash provided by operating activities	25,280	42,402
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Principal payments received on mortgage loans held for investment	668,528	510,805
Net cash provided by investing activities	668,528	510,805
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from issuance of securitization bond financing, net of fees	753,052	995,325
Proceeds from issuance of term debt and warrants, net of fees	98,557	
Payments on securitization bond financing	(676,657)	(529,853)
Payments on temporary credit facilities	(745,267)	(977,267)
Capital contributions from parent	3,013	8,388
Net decrease in receivable from parent	(88,106)	(37,455)
Payments of common stock dividends		(12,300)
Payments of preferred stock dividends	(2,495)	(2,495)
Net cash used in financing activities	(657,903)	(555,657)
Net (decrease) increase in cash and cash equivalents	35,905	(2,450)
Beginning balance cash and cash equivalents	23,299	6,158
Ending balance cash and cash equivalents	\$ 59,204	\$ 3,708

The accompanying notes are an integral part of these financial statements.

---

**Table of Contents**

**ACCREDITED MORTGAGE LOAN REIT TRUST**

**NOTES TO UNAUDITED FINANCIAL STATEMENTS**

**1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Basis of Presentation**

Accredited Mortgage Loan REIT Trust (the REIT) was formed on May 4, 2004 as a Maryland real estate investment trust for the purpose of acquiring, holding and managing real estate assets. All of the outstanding common shares of the REIT are held by Accredited Home Lenders, Inc. (AHL), a wholly owned subsidiary of Accredited Home Lenders Holding Co., (Accredited). The accompanying financial statements of the REIT have been prepared in accordance with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements included in this report for the REIT have been prepared, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures, normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles, have been condensed or omitted pursuant to such rules and regulations. These financial statements should be read in conjunction with the audited financial statements and the related notes included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2006.

In the opinion of the Company's management, any adjustments contained in the accompanying unaudited financial statements as of and for the three months ended March 31, 2007 are of a normal recurring nature. Operating results for the three months ended March 31, 2007 are not necessarily indicative of the results that may be expected for the year ended December 31, 2007.

In addition, during the first quarter of 2007, Accredited engaged financial advisors to evaluate strategic alternatives for the Company. As a result, in June 2007, Accredited entered into an agreement with affiliates of Lone Star Fund V (U.S.) L.P. (Lone Star), pursuant to which Lone Star agreed to acquire all of Accredited's outstanding common stock through a tender offer and subsequent merger. The acquisition was expected to be completed in the third quarter of 2007 and to provide Accredited with additional capital resources for future operations. However, in mid-August 2007, Lone Star stated that it would not accept the shares tendered by shareholders. Accredited has filed suit in Delaware Chancery Court seeking to enforce Lone Star's obligations to close the tender offer and complete the merger, and a trial is scheduled to begin on September 26, 2007. If the acquisition is not consummated or if Accredited is unable to obtain adequate capital resources to fund future operations, Accredited's financial and operational viability becomes increasingly uncertain. Whether the acquisition will ultimately be completed is not presently determinable. The accompanying consolidated financial statements do not include any adjustments related to the effects of this uncertainty.

In August 2004, the REIT completed a public offering of 3,400,000 shares of 9.75% Series A Perpetual Cumulative Preferred Stock. In September 2004 the REIT sold an additional 100,000 Series A preferred shares pursuant to the exercise of the underwriters' over-allotment option. In October 2004, the REIT sold an additional 593,678 Series A preferred shares in a public offering.

The REIT engages in the business of acquiring, holding, financing, and securitizing non-prime mortgage loans secured by residential real estate. Generally, the REIT acquires mortgage assets and assumes related funding obligations from AHL, which are accounted for at AHL's carrying value, as contributions of capital from AHL. These mortgage assets consist primarily of residential mortgage loans, or interests in these mortgage loans, that have been originated or acquired by AHL. AHL focuses on borrowers who may not meet conforming underwriting guidelines because of higher loan-to-value ratios, the nature or absence of income documentation, limited credit histories, high levels of consumer debt, or past credit difficulties. AHL originates loans primarily based upon the borrower's willingness and ability to repay the loan and the adequacy of the collateral.

AHL also provides operating facilities, administration and loan servicing for the REIT. The REIT is, therefore, economically and operationally dependent on AHL, and, as such, the REIT's results of operation or financial condition may not be indicative of the conditions that would have existed for its results of operations or financial condition if it had operated as an unaffiliated entity.

The REIT has elected to be taxed as a real estate investment trust and to comply with the provisions of the Internal Revenue Code with respect thereto. Accordingly, the REIT will generally not be subject to federal or state income tax to the extent that its distributions to shareholders satisfy the real estate investment trust requirements and certain asset, income and share ownership tests are met.

**Use of Estimates**

## Edgar Filing: Accredited Mortgage Loan REIT Trust - Form 10-Q

The preparation of financial statements, in conformity with accounting principles generally accepted in the United States of America, 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 amount of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates and Assumptions included in our consolidated financial statements relate to the provision for loan losses, hedging policies and income taxes.

---

**Table of Contents**

**ACCREDITED MORTGAGE LOAN REIT TRUST**

**NOTES TO UNAUDITED FINANCIAL STATEMENTS (Continued)**

**Cash and Cash Equivalents**

For purposes of financial statement presentation, the REIT considers all liquid investments with an original maturity of three months or less to be cash equivalents. All liquid assets with an original maturity of three months or less which are not readily available for use, including cash deposits, are classified as restricted cash.

**Loans Held for Investment, Securitization Bond Financing and Provision for Losses**

Accredited's securitization program calls for the execution of securitization transactions as the principal means of increasing the size of its held for investment portfolio. In support of this program, Accredited periodically identifies mortgage loans meeting the applicable investor characteristics and transfers those mortgage loans from mortgage loans held for sale to mortgage loans held for securitization (held for investment).

Shortly before the execution of a securitization transaction, the mortgage loans held for securitization, which are originated by and to this point have been held in AHL, are contributed at the lower of cost or market (carrying amount), to the REIT. The carrying amount transferred to the REIT consists of the unpaid principal balance, the net deferred origination fees, the basis adjustment for fair value hedge accounting (from funding to contribution date) and the allowance for mortgage loan losses and are thereafter designated as mortgage loans held for investment. The mortgage loans remain mortgage loans held for securitization for approximately 10 business days prior to the close of the securitization transaction.

Mortgage loans held for investment include mortgage loans that the REIT has securitized in structures that are accounted for as financings for accounting purposes as well as mortgage loans held for a scheduled securitization. During the three months ended March 31, 2007 and 2006, the REIT completed securitizations of mortgage loans totaling \$0.8 billion and \$1.0 billion, respectively.

These securitizations are structured legally as sales, but for accounting purposes are treated as financings under SFAS No. 140 *Accounting for Transfer and Servicing of Financial Assets and Extinguishment of Liabilities - a replacement of FASB Statement No. 125*. These securitizations do not meet the qualifying special purpose entity criteria under SFAS No. 140 and related interpretations because after the mortgage loans are securitized, the securitization trusts may acquire derivatives relating to beneficial interests retained by the REIT and, AHL, as servicer, subject to applicable contractual provisions, has discretion, consistent with prudent mortgage servicing practices, to determine whether to sell or work out any mortgage loans securitized through the securitization trusts that become troubled. Accordingly, the mortgage loans remain on the balance sheet as mortgage loans held for investment, retained interests are not created for accounting purposes, and securitization bond financing replaces the warehouse debt or asset backed commercial paper originally associated with the mortgage loans held for investment. The REIT records interest income on mortgage loans held for investment and interest expense on the bonds issued in the securitizations over the life of the securitizations. Deferred debt issuance costs and discounts related to the bonds are amortized on a level yield basis over the estimated life of the bonds.

After the mortgage loans are designated as held for securitization, the REIT estimates the losses inherent in the portfolio at the balance sheet date and establishes an allowance for mortgage loan losses. The provision for mortgage loan losses on mortgage loans held for securitization is made in an amount sufficient to maintain credit loss allowances at a level considered appropriate to cover probable losses in the portfolio. The REIT defines a mortgage loan as non-accruing at the time the mortgage loan becomes 90 days or more delinquent under its payment terms. Probable losses are determined based on segmenting mortgage loans in the portfolio according to their contractual delinquency status and applying the REIT and AHL's expected loss experience. A number of other analytical tools are used to determine the reasonableness of the allowance for mortgage loan losses. Loss estimates are reviewed periodically and adjustments, if any, are reported in earnings. As these estimates are influenced by factors outside of the REIT's control, there is uncertainty inherent in these estimates, making it reasonably possible that they could change. Mortgage loans foreclosed upon or deemed uncollectible are carried at lower of cost or fair value less disposition costs.

**Table of Contents**

**ACCREDITED MORTGAGE LOAN REIT TRUST**

**NOTES TO UNAUDITED FINANCIAL STATEMENTS (Continued)**

**Derivative Financial Instruments**

As part of the REIT's interest rate management process, the REIT uses derivative financial instruments such as Eurodollar futures and options. In connection with some of the securitizations structured as financings, the REIT entered into interest rate cap agreements. In connection with five of the securitizations structured as financings, the REIT entered into interest rate swap agreements. It is not the REIT's policy to use derivatives to speculate on interest rates. In accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended and interpreted, derivative financial instruments are reported on the balance sheet at fair value.

*Cash Flow Hedges*

Pursuant to SFAS No. 133 hedge instruments have been designated as hedging the exposure to variability of cash flows from our securitization debt attributable to interest rate risk. Cash flow hedge accounting requires that the effective portion of the gain or loss in the fair value of a derivative instrument designated as a hedge be reported as a component of other comprehensive income in stockholders' equity, and recognized into earnings in the period during which the hedged transaction affects earnings pursuant to SFAS No. 133. At the inception of the hedge and on an ongoing basis, the REIT assesses whether the derivatives used in hedging transactions are highly effective in offsetting changes in cash flows of the hedged items. When it is determined that a derivative is not highly effective as a hedge, the REIT discontinues cash flow hedge accounting prospectively. In the instance cash flow hedge accounting is discontinued, the derivative will continue to be recorded on the balance sheet at its fair value. Any change in the fair value of a derivative no longer qualifying as an effective hedge is recognized in current period earnings. For terminated hedges or hedges that no longer qualify as effective, the effective portion previously recorded remains in other comprehensive income and continues to be amortized or accreted into earnings with the hedged item. The ineffective portion on the derivative instrument is reported in current earnings as a component of interest expense.

For derivative financial instruments not designated as hedge instruments, unrealized changes in fair value are recognized in the period in which the changes occur and realized gains and losses are recognized in the period when such instruments are settled.

**Mortgage Loan Origination Costs and Fees**

Loan origination fees and certain direct origination costs are deferred as an adjustment to the carrying value of the loans. These fees and costs are amortized over the life of the loan on a level yield basis for mortgage loans held for investment or recognized when prepayments occur.

**Interest Income**

Interest income is recorded when earned. Interest income represents the interest earned on loans held for investment. The REIT does not accrue interest on loans that are more than 90 days delinquent.

**Income Taxes**

The REIT has elected to be subject to taxation as a real estate investment trust under the Internal Revenue Code of 1986. As a result, the REIT will generally not be subject to federal or state income tax to the extent that the REIT distributes its earnings to its shareholders and maintains its qualification as a real estate investment trust.

**Real Estate Owned**

Real estate acquired in settlement of mortgage loans generally results when property collateralizing a mortgage loan is foreclosed upon or otherwise acquired by AHL, as our servicer, in satisfaction of the mortgage loan. Real estate acquired through foreclosure is initially recorded at its estimated fair value less costs to dispose and is carried at the lower of cost or estimated fair value less costs to dispose. Fair value is based on the net amount that the REIT could reasonably expect to receive for the asset in a current sale between a willing buyer and a willing seller, that is, other than in a forced or liquidation sale. Adjustments to the carrying value of real estate owned are made through valuation allowances and charge-offs are recognized through a charge to earnings. Legal fees and other direct costs incurred after foreclosure are expensed as incurred.



**Table of Contents****ACCREDITED MORTGAGE LOAN REIT TRUST****NOTES TO UNAUDITED FINANCIAL STATEMENTS (Continued)****Other Comprehensive Income**

Other comprehensive income includes unrealized gains and losses that are excluded from the statement of operations and are reported as a separate component in stockholders' equity. The unrealized gains and losses include unrealized gains and losses on the effective portion of cash flow hedges.

Comprehensive income is determined as follows for the three months ended March 31:

	2007	2006
	(in thousands)	
Net income	\$ 25,983	\$ 40,752
Net unrealized gains (losses) on cash flow hedges	(14,576)	24,746
Reclassification adjustment into earnings for realized gain on derivatives	(6,354)	(6,887)
Total comprehensive income	\$ 5,053	\$ 58,611

**2. CONCENTRATIONS OF RISK*****Geographical Concentration***

Properties securing mortgage loans held for investment are geographically dispersed throughout the United States. At March 31, 2007, 18% and 15% of the unpaid principal balance of mortgage loans held for investment were secured by properties located in California and Florida, respectively. At December 31, 2006, 23% and 11% of the unpaid principal balance of mortgage loans held for investment were secured by properties located in California and Florida, respectively. The remaining properties securing mortgage loans did not exceed 10% in any other state at March 31, 2007 and December 31, 2006.

An overall decline in the economy or the residential real estate market, or the occurrence of a natural disaster that is not covered by standard homeowners' insurance policies, such as an earthquake, hurricane or wildfire, could decrease the value of mortgaged properties. This, in turn, would increase the risk of delinquency, default or foreclosure on mortgage loans in our portfolio. This could restrict our and AHL's ability to originate, sell, or securitize mortgage loans, and significantly harm our business, financial condition, liquidity and results of operations.

**3. MORTGAGE LOANS HELD FOR INVESTMENT**

Mortgage loans held for investment were as follows:

	March 31, 2007	December 31, 2006
	(in thousands)	
Mortgage loans held for investment	\$ 7,484,782	\$ 7,432,443
Basis adjustment for fair value hedge accounting	(10,415)	(10,971)
Net deferred origination fees	(26,931)	(19,983)
Allowance for loan losses	(133,716)	(129,936)
Loans held for investment, net	\$ 7,313,720	\$ 7,271,553



## Edgar Filing: Accredited Mortgage Loan REIT Trust - Form 10-Q

*Allowance for losses* Activity in the allowance was as follows:

	<b>Balance at</b>				<b>Balance at</b>
	<b>Beginning</b>	<b>Contributions</b>	<b>Provision</b>	<b>Charge offs,</b>	<b>End of</b>
	<b>of Period</b>	<b>from Parent</b>	<b>for Losses</b>	<b>net</b>	<b>Period</b>
			<b>(in thousands)</b>		
<b>Three Months Ended March 31,</b>					
<b>2007:</b>					
Mortgage loans held for investment	\$ 129,936	\$ 4,676	\$ 534	\$ (1,430)	\$ 133,716
Real estate owned	22,783		14,055	(2,742)	34,096
<b>Total</b>	<b>\$ 152,719</b>	<b>\$ 4,676</b>	<b>\$ 14,589</b>	<b>\$ (4,172)</b>	<b>\$ 167,812</b>
<b>2006:</b>					
Mortgage loans held for investment	\$ 98,399	\$ 8,431	\$ 1,774	\$ (229)	\$ 108,375
Real estate owned	6,996		4,596	(1,906)	9,686
<b>Total</b>	<b>\$ 105,395</b>	<b>\$ 8,431</b>	<b>\$ 6,370</b>	<b>\$ (2,135)</b>	<b>\$ 118,061</b>

**Table of Contents****ACCREDITED MORTGAGE LOAN REIT TRUST****NOTES TO UNAUDITED FINANCIAL STATEMENTS (Continued)**

The following table summarizes delinquency amounts for mortgage loans and real estate owned before valuation allowance:

	At March 31, 2007		At December 31, 2006	
	Total Principal Amount (1)	Delinquent Principal Over 90 Days	Total Principal Amount (1)	Delinquent Principal Over 90 Days
Mortgage loans held for investment	\$ 7,518,075	\$ 315,320	\$ 7,466,508	\$ 271,375
Real estate owned	127,939	127,939	88,637	88,637
<b>Total</b>	<b>\$ 7,646,014</b>	<b>\$ 443,259</b>	<b>\$ 7,555,145</b>	<b>\$ 360,012</b>

(1) Loans acquired from Aames were recorded at fair value at purchase. The unpaid principal balances do not include these fair value adjustments.

**4. DERIVATIVE FINANCIAL INSTRUMENTS****Fair Value Hedges**

AHL uses fair value accounting as defined by SFAS No. 133 for certain derivative financial instruments used to hedge its loans held for sale prior to being contributed to the REIT, and accordingly the basis of loans held for investment held by the REIT includes the fair value basis adjustment. Fair value adjustments to mortgage loan carrying amounts are detailed in Note 3.

**Cash Flow Hedges**

The REIT utilizes cash flow hedging and cash flow hedge accounting on the variable rate portion of its securitization debt in accordance with the provisions of SFAS No. 133. A total of \$3.4 million in net effective gains before taxes, included in other comprehensive income at March 31, 2007, is expected to be recognized in earnings during the next twelve months.

	Three Months Ended March 31,	
	2007	2006
Hedge ineffectiveness recorded in earnings, included as a component of interest expense in the consolidated statements of operations as of March 31:	\$ 5,277	\$ 522
Effective unrealized gains, net of effective unrealized losses, recorded in other comprehensive income, reported as a component of stockholders' equity as of March 31:	\$ (14,576)	\$ 24,746

The following table presents the fair value of the Company's derivative instruments, including margin account balances at:

	March 31, 2007		December 31, 2006	
	Notional amount	Fair value	Notional amount	Fair value
Eurodollar futures	\$	\$	\$ 3,758,974	\$ 4,970

## Edgar Filing: Accredited Mortgage Loan REIT Trust - Form 10-Q

Options on Eurodollar futures			630,342	2,803
Interest rate swaps	5,267,221	9,859	1,951,392	(665)
Interest rate caps	1,113,044	1,586	880,717	7
	\$ 6,380,265	11,445	\$ 7,221,425	7,115
Margin account balances	N/A	684	N/A	28,408
<b>Total</b>		<b>\$ 12,129</b>		<b>\$ 35,523</b>

**Table of Contents****ACCREDITED MORTGAGE LOAN REIT TRUST****NOTES TO UNAUDITED FINANCIAL STATEMENTS (Continued)**

The fair value of derivative liabilities of \$9.2 million and \$29.1 million at March 31, 2007 and December 31, 2006, respectively, which are included in accrued expenses and other liabilities have been netted against the fair value of derivative assets shown in the table above. Notional swap amounts are not shown for securitizations in which we reverse the position of the swap embedded in the securitization trust; for these transactions the economic notional hedge amount and the net fair value of the derivatives is zero.

The change in the fair value of derivative financial instruments and the related hedged asset or liability recorded in the consolidated statements of operations for the three months ended March 31, 2007 and 2006 was as follows:

	Interest Income	Interest Expense (in thousands)	Total
<b>Three Months Ended March 31,</b>			
<b>2007:</b>			
Net unrealized gain	\$ 1,822	\$ 21,109	\$ 22,931
Net realized loss		(9,559)	(9,559)
<b>Total</b>	<b>\$ 1,822</b>	<b>\$ 11,550</b>	<b>\$ 13,372</b>
<b>2006:</b>			
Net unrealized gain (loss)	\$ 673	\$ (5,883)	\$ (5,210)
Net realized gain		13,278	13,278
<b>Total</b>	<b>\$ 673</b>	<b>\$ 7,395</b>	<b>\$ 8,068</b>

**5. CREDIT FACILITIES**

AHL and the REIT have entered into aggregate warehouse facilities to permit the securitization of mortgage loans. AHL is the primary obligor under these facilities until the loans are contributed to the REIT for securitization. The REIT then becomes the primary obligor until the loans are securitized, a period of 30 days or less. Each of the facility agreements has cross-default and cross-collateralization provisions and AHL provides a guarantee of the REIT's obligations under the facilities during the time that the REIT owns the mortgage loans.

At March 31, 2007 there were no balances outstanding under these facilities.

**6. SECURITIZATION AND OTHER FINANCING**

Securitization bond financing consisted of the following:

	March 31, 2007	December 31, 2006
	(in thousands)	
Securitized Bond Financing	\$ 7,376,711	\$ 7,281,480
Other borrowings	100,004	16,368
	7,476,715	7,297,848

## Edgar Filing: Accredited Mortgage Loan REIT Trust - Form 10-Q

Unamortized bond discounts	(13,171)	(8,639)
<b>Total financing, net</b>	<b>\$ 7,463,544</b>	<b>\$ 7,289,209</b>

### *Securitized Bond Financing:*

At March 31, 2007 securitized bond financing includes securitized bonds bearing interest at fixed rates (ranging from 2.90% to 5.68%) and at variable rates indexed to one-month LIBOR plus a spread (ranging from .04% to 2.75%) maturing through 2037. The bonds are collateralized by mortgage loans held for investment with an aggregate principal balance

**Table of Contents**

**ACCREDITED MORTGAGE LOAN REIT TRUST**

**NOTES TO UNAUDITED FINANCIAL STATEMENTS (Continued)**

outstanding of \$7.5 billion at March 31, 2007 and at December 31, 2006. Unamortized debt issuance costs included in prepaid expenses and other assets were \$24.4 million and \$23.1 million at March 31, 2007 and December 31, 2006, respectively.

Amounts collected on the mortgage loans are remitted to the respective trustees, who in turn distribute such amounts each month to the bondholders, together with other amounts received related to the mortgage loans, net of fees payable to Accredited, the trustee and the insurer of the bonds. Any remaining funds after payment of fees and distribution of principle is known as excess interest.

The securitization agreements require that a certain level of overcollateralization be maintained for the bonds. A portion of the excess interest may be initially distributed as principle to the bondholders to increase the level of overcollateralization. Once a certain level of overcollateralization has been reached, excess interest is no longer distributed as principal to the bondholders, but, rather, is passed through to Accredited. Should the level of overcollateralization fall below a required level, excess interest will again be paid as principal to the bondholders until the required level has been reached. The securitization agreements also provide that if delinquencies or losses on the underlying mortgage loans exceed certain maximums, the required level of credit enhancement would be increased.

Due to the potential for prepayments of mortgage loans, the early distribution of principal to the bondholders and the optional clean-up call, the bonds are not necessarily expected to be outstanding through the stated maturity date set forth above.

*Other Borrowings:*

On March 30, 2007, Accredited and certain of its subsidiaries entered into a secured five year term Loan Agreement with Mortgage Investment Fundings, L.L.C. ( MIF ), a lending entity managed by Farallon Capital Management. Pursuant to the Loan Agreement, MIF extended term loans guaranteed by Accredited in an aggregate principal amount of \$230,000,000 (\$130 million with AHL and \$100 million with the REIT). In conjunction with the Loan Agreement, Accredited (i) issued to MIF a warrant to purchase 3,226,431 shares of common stock of Accredited at an exercise price of \$10 per share and (ii) granted to MIF certain preemptive rights to purchase additional equity securities of Accredited, certain registration rights with respect to its equity securities in the Company and Board of Directors observer rights. The loans may be prepaid in full at any time, subject to payment of a premium of 7% of amounts prepaid during the first two years of the facility and a lesser premium thereafter. Upon the occurrence of a change of control, the lenders may demand prepayment of the loans and the loans shall be prepaid in full with a premium of 2% of the amount prepaid. At March 31, 2007 the balance outstanding in the REIT under this agreement was \$94.4 million which is net of the discount representing the fair value of the warrants at the time of issuance of \$5.6 million. The value of the warrants is included in accrued expenses and other liabilities since Accredited may be required under certain circumstances to purchase the warrants from the holders pursuant to put rights. The warrants will be adjusted to estimated fair value at each reporting period.

Our credit facilities contain extensive restrictions and covenants including minimum profitability, interest coverage, liquidity, and net worth requirements and limitations on total indebtedness. If Accredited fails to comply with any of these covenants or otherwise defaults under a facility, the lender has the right to terminate the facility and require immediate payment which may require sale of the collateral at less than optimal terms. In addition, if Accredited defaults under one facility, it would generally trigger a default under the other facilities. From January to September 2007, several of the covenant requirements were amended or waived to allow Accredited to remain in compliance with all requirements. We anticipate requiring additional amendments to or waivers of these covenants during 2007, and there can be no assurance the lenders will so agree. In the event such amendments or waivers are required and Accredited is unable to obtain them, it could have a material and adverse impact on our ability to fund mortgage loans and continue as a going concern.

The following table summarizes the expected repayments relating to the securitization and other financing at March 31, 2007 and the securitized bonds are based on anticipated receipts of principal and interest on underlying mortgage loan collateral:

	(in thousands)
Nine months ending December 31, 2007	\$ 3,975,358
Year ending December 31: 2008	1,170,377

Edgar Filing: Accredited Mortgage Loan REIT Trust - Form 10-Q

2009	761,320
2010	474,996
2011	311,662
2012	308,639
Thereafter	474,363
<b>Total</b>	<b>\$ 7,476,715</b>

**Table of Contents****ACCREDITED MORTGAGE LOAN REIT TRUST****NOTES TO UNAUDITED FINANCIAL STATEMENTS (Continued)****7. INCOME TAXES AND DISTRIBUTION OF EARNINGS**

With the filing of its first Federal income tax return on September 9, 2005, the REIT elected to be treated as a real estate investment trust for income tax purposes in accordance with certain provisions of the Internal Revenue Code of 1986. As a result of this election, the REIT will generally not be subject to federal or state income tax to the extent that it distributes its earnings to its shareholders and maintains its qualification as a real estate investment trust. Currently the REIT plans to distribute substantially all of its taxable income to common and preferred shareholders.

The REIT adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, on January 1, 2007. As part of the implementation of FIN 48, the REIT evaluated its tax positions to identify and recognize any liabilities related to unrecognized tax benefits resulting from those positions that meet the provisions of FIN 48. As a result of this evaluation, the REIT determined that it did not have material liabilities.

The following is a reconciliation of the income tax provision computed using the statutory federal income tax rate to the income tax provision reflected in the statement of operations:

	<b>Three Months Ended March 31, 2007</b>	<b>Three Months Ended March 31, 2006</b>
	(in thousands)	
Federal income tax at statutory rate	\$ 9,094	\$ 14,263
Preferred stock dividends at statutory rate	(873)	(873)
Common stock dividends paid deduction and other	(8,221)	(13,390)
Total provision	\$	\$

**8. ACCRUED EXPENSES AND OTHER LIABILITIES**

Accrued expenses and other liabilities were as follows at December 31:

	<b>March 31, 2007</b>	<b>December 31, 2006</b>
	(in thousands)	
Accrued interest	\$ 7,894	\$ 7,894
Derivative liabilities	9,247	29,141
Other liabilities general	17,481	17,977
Preferred stock dividend payable	2,495	2,495
Total	\$ 37,117	\$ 57,507

**9. PREFERRED STOCK**



## Edgar Filing: Accredited Mortgage Loan REIT Trust - Form 10-Q

The Board of Trustees, or a duly authorized committee thereof, may issue up to 200,000,000 shares of preferred stock from time to time in one or more classes or series. In addition, the Board of Trustees, or duly authorized committee thereof, may fix the preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends or other distributions, qualifications and terms and conditions of redemption.

### *9.75% Series A Perpetual Cumulative Preferred Shares*

The Board of Trustees has classified and designated 4,093,678 preferred shares as Series A Preferred Shares. At March 31, 2007 and December 31, 2006, there were 4,093,678 preferred shares issued and outstanding.

On March 1, 2007, the REIT's board of trustees declared a quarterly cash dividend on the Preferred Shares at the rate of \$0.609375 per share to shareholders of record on March 15, which aggregated \$2.5 million for the three months ended March 31, 2007.

The Series A Preferred Shares contain covenants requiring the REIT to maintain a total shareholders' equity balance and total loans held for investment of at least \$50.0 million and \$2.0 billion, respectively, commencing on December 31, 2004 and at the end of each quarter thereafter. In addition, commencing with each of the four quarters ending December 31, 2006, the REIT is also required to maintain cumulative unencumbered cash flow (as defined in the agreement) greater than or equal to six times the cumulative preferred dividends required in those four quarters. If the REIT is not in compliance with

**Table of Contents****ACCREDITED MORTGAGE LOAN REIT TRUST****NOTES TO UNAUDITED FINANCIAL STATEMENTS (Continued)**

any of these covenants, no dividends can be declared on the REIT's common shares until it is in compliance with all covenants as of the end of two successive quarters. As of March 31, 2007, the REIT was in compliance with the covenants applicable to date in 2007.

Accredited irrevocably and unconditionally agrees to pay in full to the holders of each share of the REIT's Series A Preferred Shares, as and when due, regardless of any defense, right of set-off or counterclaim which the REIT or Accredited may have or assert: (i) all accrued and unpaid dividends (whether or not declared) payable on the REIT's Series A Preferred Shares; (ii) the redemption price (including all accrued and unpaid dividends) payable with respect to any of the REIT's Series A Preferred Shares redeemed by the REIT and (iii) the liquidation preference, if any, payable with respect to any of the REIT's Series A Preferred Shares. Accredited's guarantee is subordinated in right of payment to Accredited's indebtedness, on parity with the most senior class of Accredited's preferred stock and senior to Accredited's common stock.

**10. RECEIVABLE FROM PARENT AND ADMINISTRATION AND SERVICING AGREEMENT WITH PARENT**

The REIT has an administration and servicing agreement with its parent company, AHL, whereby AHL provides loan servicing, treasury, accounting, tax and other administrative services for the REIT in exchange for a management fee equal to 0.5% per year on the outstanding principal balance of the loans serviced, plus miscellaneous fee income collected from mortgagors including late payment charges, assumption fees and similar items. Under this agreement, either party agrees to pay interest on the net average balance payable to the other party at an annual rate equal to the Six-Month LIBOR plus 1.0%. Management fee expense under this agreement totaled \$9.8 million and \$7.8 million for the three months ended March 31, 2007 and 2006, respectively. Interest income under this agreement totaled \$2.4 million and \$1.6 million for the three months ended March 31, 2007 and 2006, respectively. At March 31, 2007 and December 31, 2006, the net receivable from parent was \$200.5 million and \$112.4 million, respectively. The net receivable from parent results from advances of excess cash holdings by the REIT to AHL. We expect the net receivable will be reduced at the time the REIT pays common stock dividends to AHL. Pursuant to the right of offset under the agreement between the parties, the net receivable will accrue interest at an annual rate equal to the six-month LIBOR plus 1.0%.

**11. SUPPLEMENTAL CASH FLOW INFORMATION**

The following represents supplemental cash flow information:

	<b>Three Months Ended March 31,</b>	
	<b>2007</b>	<b>2006</b>
	<b>(in thousands)</b>	
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</b>		
Cash paid during the year for interest	\$ 108,693	\$ 61,147
<b>SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:</b>		
Transfer of loans held for investment to real estate owned, net of reserves, included in other assets	\$ 39,302	\$ 6,725
<b>Detail of assets and liabilities contributed from parent:</b>		
Cash contributions	\$	\$ 8,388
Mortgage loans, net of reserves	752,013	986,931
Other net liabilities	(10,504)	(8,730)
Outstanding balances on warehouse credit facilities	(745,267)	(977,995)
	\$ (3,758)	\$ 8,594

---

**Table of Contents**

**ACCREDITED MORTGAGE LOAN REIT TRUST**

**NOTES TO UNAUDITED FINANCIAL STATEMENTS (Continued)**

**12. COMMITMENTS AND CONTINGENCIES**

In September 2007, we were named as a defendant under the consolidated, amended complaint in *Atlas v. Accredited Home Lenders Holding Co., et al.*, a class action pending in the United States District Court for the Southern District of California. The suit alleges violations of federal securities laws and originally named as defendants AHLHC and certain members of its senior management. Pursuant to the Private Securities Litigation Reform Act, five similar class actions were consolidated with the *Atlas* matter, and a lead plaintiff was selected. The consolidated, amended complaint was filed on August 24, 2007, and added as defendants the REIT and certain directors of AHLHC. However, as of September 17, 2007, we had not been served with the complaint. If we are served with the complaint, we intend to vigorously defend this matter. The ultimate outcome of this matter and the amount of liability, if any, which may result, is not presently determinable, but we do not believe it will have a material adverse effect on our business.

In July 2007, we, AHL and AHLHC were served with a complaint, *National Community Reinvestment Coalition ( NCRC ) v. Accredited Home Lenders Holding Company [sic], et al.*, brought in the United States District Court for the District of Columbia. The complaint alleges that we, AHL and AHLHC engaged in a practice of discriminating against African-American and Latinos by requiring minimum property values of \$100,000 on row homes for certain loan programs and prohibiting the use of row homes as collateral for certain other loan programs, without business justification for those restrictions. Plaintiff seeks compensatory and punitive damages, declaratory and injunctive relief, and recovery of attorneys' fees and costs of suit. There has been no ruling on the merits of plaintiff's claims. We, AHL and AHLHC intend to vigorously defend this action. The ultimate outcome of this matter and the amount of liability, if any, which may result is not presently determinable, but we do not believe it will have a material adverse effect on our business.

**13. SUBSEQUENT EVENTS**

On March 15, 2007, Accredited received a notice from the staff of NASDAQ stating that Accredited common stock may be subject to delisting because it had not filed its Annual Report on Form 10-K for the year ended December 31, 2006 on a timely basis. Accredited requested a hearing before the NASDAQ Listing Qualifications Panel (the Panel) to appeal the NASDAQ staff's determination and to present its plan to regain compliance with NASDAQ's filing requirements, which was held on May 3, 2007, followed by a written submission dated May 21, 2007. The hearing request automatically stayed the delisting of the common stock pending the Panel's review and decision. In addition, on May 15, 2007 and on August 14, 2007, Accredited received additional deficiency notices from the staff of NASDAQ stating that the failure to timely file with the SEC its Quarterly Report on Form 10-Q for the quarters ended March 31, 2007 and June 30, 2007, respectively could serve as an additional basis for the delisting of Accredited's securities from NASDAQ.

On July 23, 2007 the Panel determined to continue listing Accredited's common stock provided that Accredited filed with the SEC its 10-K by September 12, 2007 and its 10-Q for the first quarter of 2007 by September 18, 2007. The 10-K was filed with the SEC on August 2, 2007. The Panel has not yet responded to Accredited's August 17, 2007 request for additional time to file its 10-Q for the second quarter of 2007, but Accredited anticipates the Panel will not require such 10-Q to be filed before the September 18, 2007 deadline for the first quarter 10-Q.

If Accredited is unable to continue to list its common stock for trading on NASDAQ, there may be an adverse impact on the market price and liquidity of Accredited's common stock, and the stock may be subject to the penny stock rules contained in Section 15(g) of the Securities Exchange Act of 1934, as amended, and the rules promulgated thereunder. Delisting of Accredited's common stock from NASDAQ could also materially adversely affect its business, including, among other things: its ability to raise additional financing to fund its operations; its ability to attract and retain customers; and its ability to attract and retain personnel, including management personnel. In addition, if Accredited is unable to list its common stock for trading on NASDAQ, many institutional investors would no longer be able to retain their interests in and/or make further investments in Accredited common stock because of their internal rules and protocols.

In addition, by May 31, 2007, based upon market conditions adversely impacting the salability of any asset-backed commercial paper notes collateralized by non-prime mortgage loans, Accredited voluntarily terminated its asset-backed commercial paper program and repaid all amounts outstanding.

On June 4, 2007 Accredited entered into a definitive merger agreement with affiliates of Lone Star Fund V (U.S.), L.P. ( Lone Star ) to acquire all of Accredited's common stock in an all-cash transaction. Under the terms of the agreement, Lone Star agreed to acquire each outstanding share of

## Edgar Filing: Accredited Mortgage Loan REIT Trust - Form 10-Q

Accredited s common stock at a price of \$15.10 per share, for a total consideration of approximately \$400 million on a fully diluted basis. Our outstanding Preferred Shares would be expected to remain outstanding following the consummation of the acquisition.

**Table of Contents**

**ACCREDITED MORTGAGE LOAN REIT TRUST**

**NOTES TO UNAUDITED FINANCIAL STATEMENTS (Continued)**

The merger agreement sets forth customary conditions to the closing of the tender offer, including the tender of a majority of the outstanding Accredited shares and the receipt of certain required regulatory approvals. Accredited believed that all conditions to the closing of the tender offer were satisfied at the offer's scheduled expiration at midnight, New York City time, on August 14, 2007. However, on August 10, 2007, Lone Star alleged in a filing made with the SEC that, in light of the drastic deterioration in the financial and operational condition of the Company, among other things, Lone Star believed the Company would fail to satisfy the conditions to the closing of the tender offer and, accordingly, that Lone Star did not expect to be accepting shares tendered as of the scheduled expiration of the tender offer. On August 11, 2007, Accredited filed a lawsuit against Lone Star in the Delaware Court of Chancery seeking specific performance of Lone Star's obligations to close the tender offer and complete the merger. A trial in the lawsuit is scheduled to begin on September 26, 2007.

In June and September 2007, we declared quarterly cash dividends on our Preferred Shares at the rate of \$0.609375 per share. The second quarter dividend was paid on July 2, 2007 to preferred shareholders of record at the close of business on June 15, 2007. The third quarter dividend is scheduled to be paid on October 1, 2007 to preferred shareholders of record at the close of business on September 14, 2007.

---

**Table of Contents**

**ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion should be reviewed in conjunction with our financial statements and the related notes and other financial information appearing elsewhere in this report. In addition to historical information, the following discussion and other parts of this document contain forward-looking information that involves risks and uncertainties. Please refer to the section entitled "Forward-Looking Statements" on page 5 of this Form 10-Q. Our actual results could differ materially from those anticipated by such forward-looking information due to factors discussed under the section below entitled "Risk Factors" and elsewhere in this report.

**General**

Accredited Mortgage Loan REIT Trust (the "REIT") was formed on May 4, 2004 as a Maryland real estate investment trust for the purpose of acquiring, holding and managing real estate assets. All of our outstanding common shares are held by Accredited Home Lenders, Inc. ("AHL"), a wholly-owned subsidiary of Accredited Home Lenders Holding Co ("Accredited").

Our intention is to hold all securitized loans and related securitization bond financing activities of AHL. We acquire mortgage assets and assume related funding obligations from AHL, who also provides operating facilities, administration and servicing for us. We are, therefore, economically and operationally dependent on AHL, and, as such, our results of operations or financial condition may not be indicative of the conditions that would have existed for our results of operations or financial condition if we had operated as an unaffiliated entity.

The REIT has elected to be taxed as a real estate investment trust and to comply with the provisions of the Internal Revenue Code with respect thereto. Accordingly, we will generally not be subject to federal or state income tax to the extent that distributions to shareholders satisfy the real estate investment trust requirements and certain asset, income and share ownership tests are met.

Our operations generate revenues from interest income over the life of the loans that we have securitized in structures that require financing treatment for accounting purposes. This interest income is partially offset by (1) the interest expense we pay on the bonds that we issue to repay warehouse debt incurred to fund these loans, (2) the fees and expenses of securitization participants, such as the servicer and the trustees and (3) the provision for losses on the loans. The provision for loan losses is generally determined as the amount sufficient to maintain credit loss reserves at a level considered by us to be adequate to cover probable losses in the securitized loan portfolio.

Although the securitizations are legally structured as sales for accounting purposes they are treated as financings under Statement of Financial Accounting Standards ("SFAS") No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities - a replacement of FASB Statement No. 125*. The securitizations do not meet the qualifying special purpose entity criteria under SFAS No. 140 and related interpretations because after the mortgage loans are securitized, the securitization trust may acquire derivatives relating to beneficial interests retained by us. Also, AHL, as servicer, subject to applicable contractual provisions, has sole discretion to use its best commercial judgment in determining whether to sell or work out any mortgage loans securitized through the securitization trust that become troubled. Accordingly, the mortgage loans and securitization indebtedness are included in our balance sheet. We record interest income on the mortgage loans and interest expense on the securities issued from the securitization over the life of the securitization. Our profitability in large part depends on the difference, or spread, between these amounts.

We expect our mortgage loan portfolio to change based on the trend of receiving capital contributions of assets and liabilities from AHL for our periodic securitizations. To the extent that the contributions of mortgage loans for securitizations by AHL are greater than the rate of payments received on existing securitized mortgage loans, we would expect our total mortgage loan portfolio to grow. On the other hand, if the rate of payments received on existing securitized mortgage loans exceeds the contributions of mortgage loans for securitizations by AHL, we would expect our total mortgage loan portfolio to contract.

We anticipate that our results of operations will fluctuate on a quarterly and annual basis. The timing and degree of fluctuation will depend upon several factors, including competition, economic slowdowns and increased interest rates in addition to those discussed under "Risk Factors". We cannot assure you that we will be able to sustain revenue growth or maintain profitability on a quarterly or annual basis or that our growth will be consistent with predictions made, if any, by securities analysts.

---

## **Table of Contents**

### ***Lone Star acquisition of Accredited***

On June 4, 2007 Accredited entered into an Agreement and Plan of Merger with affiliates of Lone Star Fund V (U.S.) L.P. ( Lone Star ) pursuant to which Lone Star agreed to acquire all of the common stock of Accredited in an all-cash transaction. Under the terms of the agreement, Lone Star agreed to acquire each outstanding share of Accredited common stock at a price of \$15.10 per share, for a total consideration of approximately \$400 million on a fully diluted basis. We anticipate the outstanding 9.75% Series A Perpetual Cumulative Preferred Shares, par value \$1.00 per share (the Series A Preferred ), of Accredited Mortgage Loan REIT Trust (NYSE:AHH-PA) will continue to remain outstanding.

On August 10, 2007, Lone Star stated in a filing made with the SEC that, in light of the drastic deterioration in the financial and operational condition of Accredited, among other things, Lone Star believed Accredited would fail to satisfy the conditions to the closing of the tender offer and, accordingly, that Lone Star did not expect to be accepting shares tendered as of the scheduled expiration of the tender offer at midnight, New York City time, on August 14, 2007.

On August 11, 2007, Accredited filed a lawsuit against Lone Star in the Delaware Court of Chancery seeking specific performance of Lone Star's obligations to close the tender offer and complete the merger. A trial in the lawsuit is scheduled to begin on September 26, 2007.

### **Recent Developments**

#### ***Strategic Restructurings***

In response to the ongoing turmoil in the non-prime mortgage industry, beginning in September 2007, Accredited restructured its operations by closing its retail lending operations, substantially reducing its wholesale lending operations, laying off approximately 60% of its workforce and substantially suspending U.S. mortgage loan originations. Accredited does not intend to resume non-prime mortgage loan originations unless and until the return of market conditions under which non-prime mortgage loans can be originated and sold or securitized at a profit. Accredited intends to continue and enhance its mortgage loan servicing operations, and also intends to continue its Canadian mortgage origination operations, as long as financing and an acceptable secondary market remain available for the Canadian operations. The survival of the downsized operations will be primarily dependent upon income derived from Accredited's servicing operations, the residual interests in previously securitized loans (most of which are held in the REIT) and its Canadian mortgage loan originations. There can be no assurance that these sources of income will be sufficient to fund the downsized operations pending the return of market conditions under which mortgage loans can be originated and sold or securitized at a profit.

#### ***Funding and Liquidity Transactions***

In February and March 2007, in response to the adverse operating environment and declining whole loan sale prices, AHL's warehouse line creditors reduced their valuations of the mortgage loan collateral securing their warehouse financing to AHL and placed significant margin calls on AHL to post additional cash to cover the decrease. To alleviate the pressures from these margin calls, on March 16, 2007, AHL sold \$2.7 billion of loans held for sale at a substantial discount. This sale resulted in a pre-tax loss of \$150 million in the first quarter of 2007, but provided AHL with approximately \$134 million in cash after paying off credit providers. Management believes the sale of its loans at a discount was necessary to provide additional liquidity to AHL.

On March 30, 2007, Accredited, AHL, and the REIT entered into a secured Loan Agreement with Mortgage Investment Fundings, L.L.C. (MIF), a lending entity managed by Farallon Capital Management, L.L.C. Pursuant to the Loan Agreement, MIF extended term loans guaranteed by Accredited in an aggregate principal amount of \$230 million consisting of (i) term loan to the REIT in the principal amount of \$70.0 million (the Term A Loan ), (ii) a term loan to AHL in the principal amount of \$130.0 million (the Term B Loan ), and (iii) a term loan to the REIT in the principal amount of \$30.0 million (the Term C Loan ).

The proceeds of the Term A Loan and the Term B Loan are available to fund repurchase obligations of the REIT and AHL, to satisfy margin calls from warehouse lenders, to fund mortgage loan originations, to pay for transaction costs in connection with the transaction, for general working capital and other corporate needs and to repay specific indebtedness. The Term C Loan is solely available to repay certain specified indebtedness of the REIT. The Term A and Term B loan have an interest rate of 13% annum, whereas the Term C Loan had an interest rate of 9% per annum for the first 60 days and an interest rate of 13% per annum thereafter.

Also on March 30, 2007, AHL and the REIT amended the Amended and Restated Master Repurchase Agreement, dated as of December 30, 2005, with Credit Suisse First Boston Mortgage Capital LLC ( CSFB ), and entered into a Master Repurchase Agreement with Wachovia Bank, N.A. (Wachovia). Under the amended agreement with CSFB, the term of the CSFB repurchase facility was extended through March 31, 2008 and the maximum committed amount able to be borrowed remained at \$600 million. Under the agreement with Wachovia (which was amended

## Edgar Filing: Accredited Mortgage Loan REIT Trust - Form 10-Q

on July 5, 2007), the maximum amount AHL and the REIT are able to borrow is \$1 billion.



## Edgar Filing: Accredited Mortgage Loan REIT Trust - Form 10-Q

On September 4, 2007, the Company entered into an amendment to the Master Repurchase Agreement with Wachovia and on September 5, 2007 entered in an amendment to the Amended and Restated Master Repurchase Agreement with CSFB, effective on and after July 31, 2007. Pursuant to these amendments, the parties modified the definition of Adjusted Tangible Net Worth to include the amount of the Company's pool trust preferred securities. In addition, the CSFB amendment contains an additional sublimit for performing aged warehouse loans.

---

**Table of Contents**

AHL used the proceeds obtained from the sale of loans in the first quarter of 2007 and proceeds from the Farallon term notes, to repay substantially all the debt then outstanding on its warehouse credit facilities. Concurrent with the repayment of these facilities, AHL terminated many of the warehouse credit lines and obtained waivers or amendments with respect to certain covenants on the remaining facilities. In exchange for the waivers granted, AHL agreed that it would not seek additional borrowings under these credit agreements. As of August 31, 2007, those non-funding facilities had also been terminated.

In May 2007, due to market conditions adversely impacting the salability of any asset-backed commercial paper notes collateralized by non-prime mortgage loans, AHL terminated its \$2.5 billion asset-backed commercial paper facility and repaid the related short-term liquidity notes and subordinated notes.

During the quarter ended June 30, 2007, AHL sold over \$1 billion of mortgage loans in whole loan sale transactions at a premium above par.

On August 17, 2007, AHL entered into an agreement to trade \$1 billion of loans to be settled in a series of transactions over a 60-day period with a single investor at an advance rate comparable to the advance rates they were receiving from their warehouse lenders at the time. Under the agreement, AHL has the ability but not the obligation, to repurchase all of the loans at a premium to the advance rate. If the loans are not repurchased by AHL by mid-November 2007, their right to repurchase the loans expires and the investor will keep the loans with limited recourse to AHL. The transaction neither produced nor used any significant liquidity at time of funding. The transaction will reduce the Company's exposure to margin calls on these loans since the agreement does not permit the investor to decrease the advance rate during the 90-day repurchase period.

***This Quarterly Report on Form 10-Q has not been filed on a timely basis***

Our Annual Report on Form 10-K ( 10-K ) for the year ended December 31, 2006 and this Quarterly Report on Form 10-Q were not filed with the Securities and Exchange Commission ( SEC ) on a timely basis, and our Quarterly Report on Form 10-Q for the three months ended June 30, 2007 is delinquent. These delinquencies have had adverse consequences to us, and may continue to have certain adverse consequences even after they have been filed, including, for example, making us ineligible to register our securities for sale with the SEC using a short-form registration.

***NYSE Monitoring Notification***

On April 18, 2007, we received a notice from the staff of the New York Stock Exchange ( NYSE Regulation ) stating that the NYSE Regulation staff will monitor the status of our 10-K and related public disclosures for a six-month period beginning April 17, 2007. The notice was generated as the result of our failure to file our annual report for the year ended December 31, 2006 with the SEC on a timely basis. We filed our 10-K with the SEC on August 2, 2007. Shares of our 9.75% Series A Perpetual Cumulative Preferred Shares ( Preferred Shares ) are traded on the NYSE. The NYSE action is being taken in accordance with Rule 802.01E of NYSE's Listed Company Manual.

***NASDAQ Delisting Notification***

On March 15, 2007, Accredited received a notice from the staff of NASDAQ stating that Accredited common stock may be subject to delisting because it had not filed its 10-K for the year ended December 31, 2006 on a timely basis. Accredited requested a hearing before the NASDAQ Listing Qualifications Panel to appeal the NASDAQ staff's determination and to present its plan to regain compliance with NASDAQ's filing requirements, which was held on May 3, 2007, followed by a written submission dated May 21, 2007. The hearing request automatically stayed the delisting of the common stock pending the Panel's review and decision. In addition, on May 15, 2007 and on August 14, 2007, Accredited received additional deficiency notices from the staff of NASDAQ stating that the failure to timely file with the SEC its 10-Q for the quarters ended March 31, 2007 and June 30, 2007, respectively could serve as an additional basis for the delisting of Accredited's securities from NASDAQ.

On July 23, 2007 the Panel determined to continue listing Accredited's common stock provided that they filed with the SEC their 10-K by September 12, 2007 and their 10-Q for the first quarter of 2007 by September 18, 2007. The 10-K was filed with the SEC on August 2, 2007. The Panel has not yet responded to Accredited's August 17, 2007 request for additional time to file our 10-Q for the second quarter of 2007, but anticipate the Panel will not require such 10-Q to be filed before the September 18, 2007 deadline for the first quarter 10-Q.

**Table of Contents**

If Accredited is unable to continue to list its common stock for trading on NASDAQ, there may be an adverse impact on the market price and liquidity of Accredited's common stock, and the stock may be subject to the penny stock rules contained in Section 15(g) of the Securities Exchange Act of 1934, as amended, and the rules promulgated thereunder. Delisting of Accredited's common stock from NASDAQ could also materially adversely affect its business, including, among other things: its ability to raise additional financing to fund its operations; its ability to attract and retain customers; and its ability to attract and retain personnel, including management personnel. In addition, if Accredited is unable to list its common stock for trading on NASDAQ, many institutional investors would no longer be able to retain their interests in and/or make further investments in Accredited common stock because of their internal rules and protocols.

**Class Action Lawsuits**

In 2007, several class action lawsuits were filed against Accredited and certain of its officers and directors. Certain of the lawsuits generally allege that, between November 1, 2005 and March 12, 2007, Accredited issued materially false and misleading statements regarding their business and financial results causing Accredited stock to trade at artificially inflated prices. Other complaints allege breaches of fiduciary duty by Accredited and members of its Board of Directors in connection with Accredited's entry into an Agreement and Plan of Merger with affiliates of Lone Star Fund V (U.S.) L.P. Accredited believes that the lawsuits have no merit and intends to vigorously defend the cases.

**Securitized \$760 million of non-prime loans**

On January 30, 2007 the REIT completed a securitization for \$760 million in asset-backed securities. The related bonds accrue interest at one-month LIBOR plus various spread and mature in 2037.

**Paid first and second quarter dividends, and declared third quarter dividend on the REIT Series A Preferred Stock**

The Pricing Committee of the Board of Trustees of the REIT authorized, and the REIT declared in March, June and September of 2007, the quarterly cash dividend on the REIT Series A Preferred Stock at the rate of \$0.609375 per share. The first and second quarter dividends were paid on April 2 and July 2, 2007, respectively, to preferred shareholders of record at the close of business on March 15, 2007 and June 15, 2007, respectively. The third quarter dividend is scheduled to be paid on October 1, 2007 to preferred shareholders of record at the close of business on September 14, 2007.

**Results of Operations**

**Three Months Ended March 31, 2007 Compared to the Three Months Ended March 31, 2006**

**Net Revenues**

Net revenues and key indicators that affected our net revenues were as follows for the three months ended March 31:

	2007	2006	Change	% Change
	(dollars in thousands)			
Interest income	\$ 149,708	\$ 125,719	\$ 23,989	19.1%
Interest expense	(99,466)	(71,476)	(27,990)	39.2%
Net interest income	50,242	54,243	(4,001)	(7.4)%
Provision for losses	(14,589)	(6,370)	(8,219)	129.0%
Net interest income after provision	35,653	47,873	(12,220)	(25.5)%
Other income	430	688	(258)	(37.5)%
Total net revenues	\$ 36,083	\$ 48,561	\$ (12,478)	(25.7)%
Average inventory of mortgage loans held for investment	\$ 7,904,870	\$ 6,473,292	\$ 1,431,578	22.1%
Annualized interest income as a percentage of average inventory of mortgage loans held for investment	7.58%	7.77%		

- 
- (1) Interest income includes prepayment penalty income and gains and losses from certain hedging activities.
  - (2) Interest expense includes gains and losses from hedging activities and amortization of debt issuance costs.

**Table of Contents**

**Interest Income and Expense**

Interest income increased \$23.1 million or 20.4%, from \$113.0 million for the three months ended March 31, 2006 to \$136.1 million for the same period in 2007. This increase was primarily the result of a \$1.4 billion or 22.1% increase in the average portfolio (including \$1.2 billion from Aames) from \$6.5 billion in 2006 to \$7.9 billion in 2007 and a slight decrease in the yield rate on the loans, from 6.98% in 2006 to 6.89% in 2007. Prepayment penalty fees received and other income was \$13.6 million for the three months ended March 31, 2007 and was consistent with the \$12.7 million recorded for the same period in 2006. The \$1.4 billion increase in the average portfolio of loans held for investment was caused by the addition of \$2.2 billion in securitized loans during the twelve months ended March 31, 2007 and the \$1.2 billion in securitized loans acquired from Aames held during the first quarter of 2007, less normal portfolio run-off due to principal repayments.

Interest expense increased \$32.9 million or 43.4% from \$75.7 million for the three months ended March 31, 2006 to \$108.6 million for the same period in 2007. This increase in interest expense was the result of (1) a \$1.3 billion or 21.0% increase in our securitized bond financing (including \$1.2 billion from Aames), from \$6.4 billion in 2006 to \$7.8 billion in 2007, (2) an 87 basis point increase in our cost of funds rate, from 4.71% in 2006 to 5.58% in 2007 and (3) a 21 basis point (\$4.9 million) increase in hedging gains (that served to lower the effective cost of funds rate). The 87 basis point increase in our cost of funds rate was caused by the increase in the average One Month LIBOR rate from 4.61% in the first quarter of 2006 to 5.32% in the first quarter of 2007. The \$1.3 billion increase in the average securitized bond financing was the result of the addition of \$2.2 billion in securitized bonds during the twelve months ended March 31, 2007 and the \$1.2 billion in securitized bonds acquired from Aames and held during the first quarter of 2007, less normal bond amortization.

The resulting interest spread on our mortgage loans held for investment portfolio declined \$4.0 million from \$54.2 million for the three months ended March 31, 2006 to \$50.2 million for the same period in 2007. Although the average portfolio grew by \$1.4 billion, the interest yield (including prepayment penalty fees) declined by 19 basis points and the cost of funds (including hedging gains) increased by 66 basis points causing the net interest spread to contract by 81 basis points, from 3.32% in 2006 to 2.47% in 2007.

The components of our net interest margin were as follows for the three months ended March 31:

	Interest Income (Expense)	2007 Average Balance Outstanding	Average Rate  (dollars in thousands)	Interest Income (Expense)	2006 Average Balance Outstanding	Average Rate
<b>Mortgage loans held for investment:</b>						
Interest income	\$ 136,120	\$ 7,904,870	6.89%	\$ 113,010	\$ 6,473,292	6.98%
Prepayment penalty and other income	13,588		0.69	12,710		0.79
Interest expense	(108,621)	7,783,185	(5.58)	(75,728)	6,433,381	(4.71)
Hedging gains and bond issue cost amortization	9,155		0.47	4,251		0.26
Spread	50,242		2.47	54,243		3.32
Net interest margin	\$ 50,242	\$ 7,904,870	2.54%	\$ 54,243	\$ 6,473,292	3.35%

**Provision and Reserves for Losses**

The provision for losses and related reserves were comprised of the following:

	2007	2006	Change	% Change
	(dollars in thousands)			
<b>Provision for losses for the three months ended March 31:</b>				
Mortgage loans held for investment (1)	\$ 534	\$ 1,774	\$ (1,240)	(69.9)%
Real estate owned	14,055	4,596	9,459	205.8%
Total provision for losses	\$ 14,589	\$ 6,370	\$ 8,219	129.0%

Edgar Filing: Accredited Mortgage Loan REIT Trust - Form 10-Q

	March 31,	December 31,		
	2007	2006	Change	% Change
	(dollars in thousands)			
<b>Reserves for losses at period end:</b>				
Mortgage loans held for investment (1)(2)	\$ 133,716	\$ 129,936	\$ 3,780	2.9%
Real estate owned (3)	34,096	22,783	11,313	49.7%
<b>Total reserves for losses</b>	<b>\$ 167,812</b>	<b>\$ 152,719</b>	<b>\$ 15,093</b>	<b>9.9%</b>
<b>Principal balance at period end:</b>				
Mortgage loans held for investment (1)	\$ 6,411,927	\$ 6,268,944	\$ 142,983	2.3%
<b>Reserve balance as a percentage of mortgage loans held for investment (4)</b>	<b>2.09%</b>	<b>2.07%</b>		

- (1) The provision for losses on mortgage loans held for investment in 2007 excludes the provision for losses on Aames mortgage loans due to the effect of purchase accounting. The reserve for losses on mortgage loans held for investment and principal balance of mortgage loans held for investment at March 31, 2007 also exclude any Aames related balances for consistency in presentation within this table.

---

**Table of Contents**

- (2) Reserves for losses on mortgage loans held for investment are included in mortgage loans held for investment on the balance sheets.
- (3) Reserves for losses on real estate owned are included in real estate owned on the balance sheets.
- (4) The reserve balance percentages for mortgage loans held for investment are calculated by dividing the reserve for losses on mortgage loans held for investment by the principal balance of mortgage loans held for investment.

We make provisions for losses on our portfolio of mortgage loans held for investment based upon our estimate of expected losses resulting from loans in various stages of delinquency, calculated using assumptions of loss frequency and loss severity. The provision for losses reflects additions to loss reserves after the mortgage loans and related reserves are contributed from AHL to the REIT.

The total provision for losses increased \$8.2 million, from \$6.4 million for the three months ended March 31, 2006 to \$14.6 million for the same period in 2007. This increase was driven by a \$103.7 million increase in real estate owned assets from \$24.2 million at March 31, 2006 to \$127.9 million at March 31, 2007.

The key ratio of loss reserves on mortgage loans held for investment to principal balance outstanding on mortgage loans held for investment remained stable at 2.09% at March 31, 2007 compared to 2.07% at December 31, 2006.

***Management Fee Assessed by Parent Company***

The management fee assessed by the parent, AHL, for servicing and general and administrative services totaled \$9.8 million for the three months ended March 31, 2007 compared to \$7.8 million for the three months ended March 31, 2006, and represents 0.5% per annum on the monthly outstanding principal balance of the loans serviced by AHL.

***Direct General and Administrative Expense***

Direct general and administrative expenses totaled \$294,000 for the three months ended March 31, 2007 and \$9,000 for the three months ended March 31, 2006 and represent audit, legal and trustee fees incurred directly by the REIT.

***Income taxes***

There is no provision for income taxes for the three months ended March 31, 2007 or for the three months ended March 31, 2006, as we expect to dividend all of our 2007 taxable income to preferred and common shareholders. It is anticipated that, in conjunction with satisfying the ongoing distribution requirements applicable to a real estate investment trust, we will continue to dividend all of our taxable income to shareholders. Therefore, we do not expect to record an income tax provision in 2007. Our parent company, AHL, will be subject to federal and state taxes on the taxable income that is distributed to it at the parent company's effective tax rate.

**Liquidity and Capital Resources**

***Parent Contributions***

During the three months ended March 31, 2007, AHL contributed to the REIT mortgage loans, net of reserves, of \$752.0 million, and other net liabilities of \$10.5 million, and reduced by contributions of aggregate outstanding credit facility balances of \$745.3 million. AHL may from time-to-time in the future contribute additional capital or other net assets to us.

## **Table of Contents**

On March 30, 2007, Accredited, AHL, and the REIT entered into a secured Loan Agreement with Mortgage Investment Fundings, L.L.C. (MIF), a lending entity managed by Farallon Capital Management, L.L.C. Pursuant to the Loan Agreement, MIF extended term loans guaranteed by Accredited in an aggregate principal amount of \$230 million consisting of (i) term loan to the REIT in the principal amount of \$70.0 million (the Term A Loan ), (ii) a term loan to AHL in the principal amount of \$130.0 million (the Term B Loan ), and (iii) a term loan to the REIT in the principal amount of \$30.0 million (the Term C Loan ).

The proceeds of the Term A Loan and the Term B Loan are available to fund repurchase obligations of the REIT and AHL, to satisfy margin calls from warehouse lenders, to fund mortgage loan originations, to pay for transaction costs in connection with the transaction, for general working capital and other corporate needs and to repay specific indebtedness. The Term C Loan is solely available to repay certain specified indebtedness of the REIT. The Term A and Term B loan have an interest rate of 13% annum, whereas the Term C Loan had an interest rate of 9% per annum for the first 60 days and an interest rate of 13% per annum thereafter.

### *Preferred Stock*

The Pricing Committee of the Board of Trustees of the REIT authorized, and the REIT declared in March, June and September of 2007, the quarterly cash dividend on the REIT Series A Preferred Stock at the rate of \$0.609375 per share. The first and second quarter dividends were paid on April 2 and July 2, 2007, respectively, to preferred shareholders of record at the close of business on March 15, 2007 and June 15, 2007, respectively. The third quarter dividend is scheduled to be paid on October 1, 2007 to preferred shareholders of record at the close of business on September 14, 2007.

The Series A Preferred Shares contain covenants requiring us to maintain a total shareholders' equity balance and total loans held for investment of at least \$50 million and \$2.0 billion, respectively, commencing on December 31, 2004 and at the end of each quarter thereafter, and, commencing with each of the four quarters ending December 31, 2006, to maintain a cumulative unencumbered cash flow greater than or equal to six times the cumulative preferred dividends required in those four quarters. If we are not in compliance with any of these covenants, no dividends can be declared on our common stock until we are in compliance with all covenants as of the end of two successive quarters. As of March 31, 2007, we were in compliance with the covenants applicable to date in 2007.

### *Securitizations*

In March 2007, we completed a securitization containing \$760.0 million of first and second priority residential mortgage loans through the REIT. The securitization utilized a senior/subordinated structure consisting of senior and subordinated notes with a final stated maturity date in approximately thirty years. The securitization is structured as a financing; therefore, both the mortgage loans and the debt represented by the notes will remain on our consolidated balance sheet. We used the proceeds from this securitization primarily to repay warehouse financing for the mortgage loans.

### *Summary of Cash Activity*

Cash provided by operating activities of \$25.3 million, cash provided by principal payments received on mortgage loans held for investment of \$668.5 million, cash capital contributions from AHL of \$3.0 million and net proceeds from the issuance of securitized bond financing of \$753.0 million during the three months ended March 31, 2007 were used primarily to pay off outstanding credit facility balances contributed by AHL of \$745.3 million, to fund payments on the securitization bond financing of \$676.7 million and to pay dividends on our preferred stock of \$2.5 million.

### *Credit Facilities*

Accredited repaid outstanding borrowings in the amount of \$16 million related to unsold portions of securitized bonds and the facility was repaid and terminated. Additionally, the REIT terminated two \$100 million Master Repurchase Agreements secured by owner trust certificates of securitized mortgage loans for which the REIT was depositor.

### *Parent Guarantee*

Accredited irrevocably and unconditionally has agreed to pay in full to the holders of each share of our Series A Preferred Shares, as and when due, regardless of any defense, right of set-off or counterclaim which we or Accredited may have or assert: (i) all accrued and unpaid dividends (whether or not declared) payable on our Series A Preferred Shares, (ii) the redemption price (including all accrued and unpaid dividends) payable with respect to any of the REIT's Series A Preferred Shares redeemed by us and (iii) the liquidation preference, if any, payable with respect to any of our Series A Preferred Shares. Accredited's guarantee is subordinated in right of payment to Accredited's indebtedness, on parity



Edgar Filing: Accredited Mortgage Loan REIT Trust - Form 10-Q

with the most senior class of Accredited s preferred stock and senior to Accredited s common stock.

## **Table of Contents**

Cash required for the payment of preferred stock dividends in excess of cash provided by operating activities would be advanced by AHL. The full payment of the preferred stock dividend is irrevocably and unconditionally guaranteed by AHL.

We are required to distribute 90% or more of our taxable income to our sole shareholder, AHL. Because the dividend is based upon taxable income there can be a significant difference between our reported results under generally accepted accounting principles and US federal taxable income for the same period. As a result of this our dividend distributions have exceeded our net cash provided by operating activities. However, over time our reported income and taxable income should be substantially equivalent and therefore our cash flows should be sufficient to satisfy our common dividend requirements.

## **Market Risk**

Market risks generally represent the risk of loss that may result from the potential change in the value of a financial instrument due to fluctuations in interest and foreign exchange rates and in equity and commodity prices. Our market risk relates primarily to interest rate fluctuations. We may be directly affected by the level of and fluctuations in interest rates, which affect the spread between the rate of interest received on our mortgage loans held for investment and the related financing rate. Our profitability could be adversely affected during any period of unexpected or rapid changes in interest rates, by impacting the value of loans held for investment and changing the level of loan prepayments, thereby adversely affecting our long-term net interest income.

The objective of interest rate risk management is to control the effects that interest rate fluctuations have on the value of our assets and liabilities. Our management of interest rate risk is intended to mitigate the volatility of earnings associated with fluctuations in the net interest on loans held for investment due to changes in the current market rate of interest.

We use several reports and risk management strategies to monitor, evaluate, and manage the risk profile of our loan portfolio in response to changes in the market risk. We cannot assure you, however, that we will adequately offset all risks associated with our loan portfolio.

### *Derivative Instruments and Hedging Activities*

As part of our interest rate management process, we use derivative financial instruments such as Eurodollar futures, options interest rate cap agreements and interest rate swap agreements. It is not our policy to use derivatives to speculate on interest rates. In accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended and interpreted, derivative financial instruments are reported on the balance sheet at their fair value.

### *Fair Value Hedges*

We designate certain derivative financial instruments as hedge instruments under SFAS No. 133, and, at trade date, these instruments and their hedging relationship are identified, designated and documented. For derivative financial instruments designated as hedge instruments, we evaluate the effectiveness of these hedges against the hedged asset or liability to ensure that there remains adequate correlation in the hedge relationship.

### *Cash Flow Hedges*

During the third quarter of 2004, we began utilizing cash flow hedging and implemented the use of cash flow hedge accounting on our securitization debt under SFAS No. 133. Pursuant to SFAS No. 133 hedge instruments have been designated as hedging the exposure to variability of cash flows from our securitization debt attributable to interest rate risk. Cash flow hedge accounting requires that the effective portion of the gain or loss in the fair value of a derivative instrument designated as a hedge be reported as a component of other comprehensive income in stockholders' equity, and recorded into earnings in the period during which the hedged transaction affects earnings pursuant to SFAS No. 133. The ineffective portion on the derivative instrument is reported in current earnings as a component of interest expense.

For derivative financial instruments not designated as hedge instruments, unrealized changes in fair value are recognized in the period in which the changes occur and realized gains and losses are recognized in the period when such instruments are settled.

### *Interest Rate Simulation Sensitivity Analysis*

Changes in market interest rates affect our estimations of the fair value of our securitization debt and the related derivatives. Changes in fair value that are stated below are derived based upon immediate and equal changes to market



**Table of Contents**

interest rates of various maturities. All derivative financial instruments and interest rate sensitive liabilities have been included within the sensitivity analysis presented. We model the change in value of our derivative financial instruments using outside valuation models generally recognized within the industry. Projected changes in the value of our debt as stated below are determined based on the change in net present value arising from the selected hypothetical changes in market interest rates. Changes in the fair value of our derivative positions with optionality have been included based on an immediate and equal change in market interest rates. The base or current interest rate curve is adjusted by the levels shown below as of March 31, 2007:

	+50 bp	+100 bp (in thousands)	-50 bp	-100 bp
Change in fair value of:				
Securitized debt subject to portfolio-based accounting	\$ (45,678)	\$ (90,857)	\$ 46,229	\$ 93,034
Derivatives related to securitized debt subject to portfolio-based accounting	43,323	86,948	(42,909)	(85,180)
Net change	\$ (2,355)	\$ (3,909)	\$ 3,320	\$ 7,854

The simulation analysis reflects our efforts to balance the repricing characteristics of our interest-bearing assets and liabilities.

**Contractual Obligations**

The following table summarizes our contractual obligations, excluding future interest, at March 31, 2007, and the effect such obligations are expected to have on our liquidity and cash flows in future periods:

	Total	Payments Due by Calendar Period			
		Less than 1 year	1-3 Years (in thousands)	3-5 Years	More than 5 Years
Other Borrowings	\$ 100,004	\$	\$	\$ 100,004	\$
Securitization bond financing(1)	7,376,711	3,975,360	1,931,697	786,658	682,996
Total	\$ 7,476,715	\$ 3,975,360	\$ 1,931,697	\$ 886,662	\$ 682,996

- (1) Amounts represent the expected repayment requirements based on anticipated receipts of principal and interest on underlying mortgage loan collateral. The securitization bond financing represents obligations of the respective trusts that issue the notes. The mortgage loans and other assets sold to these issuers are not available to satisfy claims of our creditors. The noteholders' recourse is limited to the pledged mortgage loans and other assets.

**Off-Balance Sheet Financing Arrangements**

As of March 31, 2007, we did not have any off-balance sheet financing arrangements.

**Critical Accounting Policies**

*Accounting for Our Loan Sales*

We have sold our loans in transactions that have been accounted for in our financial statements as securitizations structured as financings. The transactions were legally structured as sales of mortgage loans, but for accounting purposes were treated as financings under SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities - a replacement of FASB Statement No. 125*. When we enter into a securitization structured as a financing, the loans remain on our balance sheet, retained interests are not created for accounting purposes, and debt securities issued in the securitization replace the warehouse debt originally associated with the securitized mortgage loans. We record interest income on the mortgage loans and interest expense on the debt securities over the life of the securitization, instead of

## Edgar Filing: Accredited Mortgage Loan REIT Trust - Form 10-Q

recognizing a gain or loss upon closing of the transaction.

### *Estimates*

The preparation of our financial statements requires us to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although we base our estimates and assumptions on historical

## Table of Contents

experience and on various other factors that we believe to be reasonable under the circumstances, our management exercises significant judgment in the final determination of our estimates. Actual results may differ from these estimates. The following areas require significant judgments by management:

Provision for losses; and

Interest rate risk, derivatives and hedging strategies.

### *Provisions for Losses*

We provide market valuation adjustments on certain nonperforming mortgage loans. These adjustments are based upon our estimate of expected losses, calculated using loss frequency and loss severity rate assumptions, and are based upon the value that we could reasonably expect to obtain from a sale, other than in a forced or liquidation sale. Specifically, we take into account two methods. The purpose of the dual methodology is to incorporate a hybrid approach so that we are taking into account a long-term view of losses which is flexible enough to readily adapt the loss reserve model to changes in the short and medium term. The following methods are applied at the securitization pool level. At March 31, 2007 we had 16 securitized pools to which this methodology was applied.

The first method is a forecast of losses projected using our securitization pool cash flow models. This method is designed to adequately reserve for losses in the short- to medium-term. We monitor the various assumptions used, including prepayment, default, and loss curves, through management portfolio performance reports. In the second method, losses are forecasted for mortgage loans with defaults based on the various delinquency categories and an estimated lifetime loss frequency rate is applied to each bucket using severities based on historical and forecast data. This method is designed to estimate losses over the life of the pool. This is based on historical and forecast data and accounts for the seasoning of the mortgage loans in the study. We monitor the loss frequency and severity assumptions used through management portfolio performance reports and adjust our assumptions as necessary. For both methods, management considers actual historical trends, current market conditions, and forecasted future market conditions in determining assumptions.

Each reporting period an allowance for losses on mortgage loans held for investment is recorded in an amount sufficient to maintain appropriate coverage for probable losses on such mortgage loans. We periodically evaluate the estimates used in calculating expected losses, and any adjustments are reported in current earnings. As these estimates are influenced by factors outside of our control and as uncertainty is inherent in these estimates, it is reasonably possible that they could change and our estimated liability prove to be too high or too low at the measurement date.

Our estimate of expected losses could increase if our actual loss experience is different than originally estimated, or if economic factors change the value we could reasonably expect to obtain from a sale. In particular, if actual losses increase or if values reasonably expected to be obtained from a sale decrease, the provision for losses would increase. Any increase in the provision for losses would adversely affect our results of operations.

### *Interest Rate Risk, Derivatives and Hedging*

We face interest rate risk on our loans held for investment subject to portfolio-based accounting, which exists because some of these loans have fixed interest rates for a period of two, three or five years while the rate passed through to the holders of the securitization bonds is based upon an adjustable rate. We also have interest rate risk for six month adjustable loans and when the loans become adjustable after their two, three or five year fixed rate period. This is due to the loan rates resetting every six months, subject to various caps and floors, versus the monthly reset on the rate passed through to the investors in the mortgage-related securities and holders of the securitization bonds. Our use of derivatives is intended to mitigate the volatility of earnings associated with changes in the cash flows of our loans held for investment subject to portfolio-based accounting due to changes in LIBOR rates.

As part of our interest rate management process, we use derivative financial instruments such as Eurodollar futures and options on Eurodollar futures. In connection with the securitizations structured as financings, we have entered into interest rate cap agreements and interest rate swap agreements. We do not use derivatives to speculate on interest rates. In accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended and interpreted, derivative financial instruments are reported on the balance sheet at fair value.

### *Fair Value Hedges*

## Edgar Filing: Accredited Mortgage Loan REIT Trust - Form 10-Q

We designate certain derivative financial instruments as hedge instruments under SFAS No. 133, and at trade date, these instruments and their hedging relationship are identified, designated and documented. For derivative financial instruments designated as hedge instruments, we evaluate the effectiveness of these hedges against the hedged asset or liability, to ensure there remains a highly effective correlation in the hedge relationship. We have implemented fair value

## **Table of Contents**

hedge accounting on our mortgage loans held for investment, whereby certain derivatives are designated as a hedge of the fair value of mortgage loans held for investment. Changes in the fair value of such derivative instruments and changes in the fair value of the hedged assets, which are determined to be effective, are recorded as a component of interest income in the period of change. Should the hedge prove to be perfectly effective, the current period net impact to earnings would be minimal. Accordingly, the net amount recorded in the statement of operations relating to fair value hedge accounting is referred to as hedge ineffectiveness.

### *Cash Flow Hedges*

During the third quarter of 2004, we began utilizing cash flow hedging and implemented the use of cash flow hedge accounting on our securitization debt under SFAS No. 133. Pursuant to SFAS No. 133, hedge instruments have been designated as hedging the exposure to variability of cash flows from our securitization debt attributable to interest rate risk. Cash flow hedge accounting requires that the effective portion of the gain or loss in the fair value of a derivative instrument designated as a hedge be reported in other comprehensive income, and the ineffective portion be reported in current earnings.

For derivative financial instruments not designated as hedge instruments, unrealized changes in fair value are recognized in the period in which the changes occur and realized gains and losses are recognized in the period when such instruments are settled.

### **Risk Factors and Accredited's Guarantee of Our Series A Preferred Shares**

You should carefully consider the following risks, together with other matters described in this Form 10-Q in evaluating our business and prospects. If any of the events referred to actually occur, our business, financial condition, liquidity and results of operations could suffer. The risks described are not the only ones we face. Additional risks not presently known to us or that we currently deem immaterial may also impair our business operations. Certain statements in this Form 10-Q (including certain of the following risk factors) constitute forward-looking statements. Please refer to the section entitled "Forward-Looking Statements" on page 5 of this Form 10-Q.

### **Risks Related to REIT's Business**

*We are economically and operationally dependent on Accredited and AHL, and Accredited and AHL are in financial distress.*

Historically, we have acquired mortgage assets and assumed related funding obligations from AHL, who also provides operating facilities, administration and servicing for us. Accordingly, we are economically and operationally dependent on AHL and Accredited, and, as such, our results of operations and financial condition may be negatively impacted by adverse market conditions affecting Accredited and AHL.

Accredited and AHL operate in the highly volatile non-prime mortgage sector. Subsequent to December 31, 2006, the non-prime mortgage sector has been characterized by turmoil and deteriorating conditions including the withdrawal of credit by warehouse credit lenders, bankruptcy of multiple industry participants, tightening of underwriting standards, increased mortgage delinquencies and defaults by borrowers, reduced origination of non-prime mortgages, downgrades by credit rating agencies, and reduction in personnel, among others. In response to these challenging conditions and to preserve liquidity, during the first half of 2007, AHL completed on March 16, 2007 the sale of substantially all of its mortgage loans then held for sale totaling approximately \$2.7 billion, borrowed \$230 million under a five-year term note facility, restructured or terminated many credit facilities, terminated its asset-backed commercial paper program, acquired new warehouse credit facilities, downsized operations and executed significant reductions in personnel.

In addition, during the first half of 2007, Accredited engaged financial and legal advisors to evaluate strategic options to enhance liquidity, including raising additional capital. On June 4, 2007, Accredited entered into a merger agreement with affiliates of Lone Star Fund V (U.S.), L.P. ( "Lone Star" ) pursuant to which Lone Star agreed to acquire all of the common stock of Accredited in an all-cash transaction.

The merger agreement sets forth customary conditions to the closing of the tender offer, including the tender of a majority of the outstanding Accredited shares and the receipt of certain required regulatory approvals. Accredited believed that all conditions to the closing of the tender offer were satisfied at the offer's scheduled expiration at midnight, New York City time, on August 14, 2007. However, on August 10, 2007, Lone Star alleged in a filing made with the SEC that, in light of the drastic deterioration in the financial and operational condition of Accredited, among other things, Lone Star believed Accredited would fail to satisfy the conditions to the closing of the tender offer and, accordingly, that Lone Star did not expect to be accepting shares tendered as of the scheduled expiration of the tender offer. On August 11, 2007, Accredited filed a lawsuit against Lone Star in the Delaware Court of Chancery seeking specific performance of Lone Star's obligations to close the tender offer and complete the merger. A trial in the lawsuit is scheduled to begin on September 26, 2007.





## **Table of Contents**

As conditions in the non-prime mortgage industry continued to deteriorate in the third quarter of 2007, Accredited traded, on August 17, 2007, approximately \$1 billion of loans at an advance rate comparable to the advance rates Accredited was then receiving from warehouse lenders. The initial settlement of approximately \$500 million closed on August 17, 2007, with the remaining loans scheduled to trade every other week as borrowers make their first payments due under the subject loans. Under the agreement, Accredited has the ability but not the obligation, in its sole discretion, to repurchase all of the loans traded through mid-November 2007 at a premium to the advance rate.

In addition, beginning in September 2007, Accredited restructured its operations by closing all retail lending operations, significantly reducing its wholesale lending operations, and substantially suspending all U.S. mortgage loan originations unless and until the return of market conditions under which non-prime mortgage loans can again be originated and sold or securitized at a profit.

If the merger agreement is not consummated or if Accredited is unable to obtain adequate capital resources to fund future operations in the event of prolonged non-prime mortgage sector volatility and deterioration, Accredited's financial and operational viability becomes increasingly uncertain. The ultimate outcome of the merger is not presently determinable. The accompanying financial statements do not include any adjustments related to the effects of this uncertainty.

Due to these conditions outside of the control of the REIT, Accredited and AHL are forced to operate in an adverse environment for mortgage companies. A bankruptcy filing by one or both entities would be detrimental to the REIT and would constitute an event of default under the warehouse facilities and under certain securitization agreements. AHL's and our warehouse lending facilities are typically structured as repurchase agreements. Accredited's, AHL's and our borrowings under repurchase agreements may qualify for special treatment under the Bankruptcy Code, giving the lenders under such facilities the ability to avoid the automatic stay provisions of the Bankruptcy Code and to take possession of and liquidate our collateral under the repurchase agreements without delay in the event that we file for bankruptcy. Accredited's and AHL's business relies upon access to funds in order to originate mortgages. In turn, our business relies upon AHL's contribution of new mortgages. In the event of a bankruptcy filing and the lenders' seizure of the collateral securing the above obligations, AHL and Accredited would likely have great difficulty in obtaining replacement loans because they would not have sufficient collateral to secure the loans they require to continue operating. Without obtaining replacement credit facilities, AHL would be unable to continue as a going concern and would have no mortgages to contribute to the REIT. Furthermore, the special treatment of repurchase agreements under the Bankruptcy Code may make it difficult for us to recover our pledged assets in the event that a lender liquidates. Thus, the use of repurchase agreements exposes our pledged assets to risk in the event of a bankruptcy or other insolvency filing by either a lender or us.

Although an AHL bankruptcy would constitute an event of default under AHL's servicing agreements with the REIT and certain securitization agreements, the automatic stay under the Bankruptcy Code may prevent the termination of such servicing agreements without the prior approval of the court having jurisdiction over AHL's bankruptcy proceedings. AHL may have the ability to assign its rights and obligations under the servicing agreements to a successor servicer. Any delay in the servicing of the mortgages may have a detrimental value to the overall value of the mortgages.

### ***The distributions to be received by us with respect to our securitized mortgage pools are uncertain.***

The timing and amount of distributions to us with respect to securitized mortgage pools is not fixed and will be determined by the rate and timing of principal payments on the related mortgage loans (including prepayments and collections upon defaults, liquidations of the mortgage loans and payment of any prepayment charges), by the rate and timing of realized losses on the mortgage loans and by adjustments of the interest rates of certain classes of the underlying notes and adjustments of the interest rates of the mortgage loans.

### ***The distributions to be received by us with respect to the securitized mortgage pools are subordinated in right of payment to the securitization noteholders and to other fees and expenses of the underlying securitization trust.***

Payments on the mortgage loans in each mortgage pool will be available to make distributions to us only after payment of servicing fees, trustee fees, administrative fees, payment of other related specified expenses and reimbursements and payment of interest due to the securitization noteholders. Consequently, the amount of excess cash flow distributable to us is extremely sensitive to losses on the related mortgage loans (and the timing thereof), because certain amounts of realized losses with respect to a mortgage pool will be absorbed in the first instance by us, either by reduction in amounts otherwise to be received by us or by a reduction in the amount of overcollateralization provided to the securitization noteholders by the mortgage loans in the related mortgage pool. Overcollateralization is the excess of the aggregate outstanding scheduled principal balance of the mortgage loans in the related mortgage pool over the aggregate principal amount of the related securitization notes. Any such reduction in the amount of overcollateralization to a level below the applicable required overcollateralization amount will be borne by us, because any amounts otherwise available for distribution to us will be distributed instead to the securitization noteholders to restore the reduced amount of overcollateralization to the applicable required overcollateralization amount.



## **Table of Contents**

Certain decisions by AHL or us, including, but not limited to, decisions regarding whether we exercise the clean-up call and whether or not certain principal and interest advances or servicing advances are non-recoverable, may also impact the availability of cash flow to us. The clean-up call is the option to terminate the securitization trust on any payment date when the outstanding principal balance of the notes is less than or equal to a certain designated percentage of the original principal balance of the notes. In addition, amounts otherwise to be received by us may be reduced by the right of the securitization noteholders to recover the amount of interest not paid because of the application of the applicable available funds cap rate, if any.

The available funds cap rate applicable to each of the underlying notes subject to such a ceiling is generally calculated with reference to the weighted average of the interest rates of the mortgage loans in the related mortgage pool, net of servicing and trustee fees and mortgage or bond insurance premiums.

***We may not meet the continued listing criteria for the New York Stock Exchange, which could materially and adversely affect the price and liquidity of our preferred stock, our business and our financial condition.***

We have not timely filed our Quarterly Reports on Form 10-Q for the first and second quarters of 2007. If we do not file such reports within the timeframes allowed by the New York Stock Exchange ( NYSE ), our 9.75% Series A Perpetual Cumulative Preferred Shares ( Preferred Shares ) may be delisted from the NYSE. In addition, we may fail to meet other listing standards of the NYSE, including minimum market capitalization requirements, which could also result in our Preferred Shares being delisted from the NYSE.

If our Preferred Shares are delisted from the NYSE, there may be an adverse impact on the market price and liquidity of our Preferred Shares, and our Preferred Shares may be subject to the penny stock rules contained in Section 15(g) of the Securities Exchange Act of 1934, as amended, and the rules promulgated thereunder. Delisting of our Preferred Shares from NYSE could also materially adversely affect our business, including, among other things, our ability to raise additional financing to fund our operations. In addition, if our Preferred Shares are delisted from the NYSE, many institutional investors would no longer be able to retain their interests in and/or make further investments in our Preferred Shares because of their internal rules and protocols.

***The rate of prepayments and defaults on the mortgage loans in a mortgage pool will affect the timing and amount of cash flow that we will receive.***

The amount of cash flow that we will receive with respect to a securitized mortgage pool will be sensitive to the rate and timing of principal payments and realized losses on the related mortgage loans in the related mortgage pool. The amount of cash flow to us in respect of excess interest will be negatively affected by a rapid rate of principal payments and realized losses on the related mortgage loans, and the amount of distributions thereon in respect of excess interest will decrease more significantly as a result of principal payments and realized losses on the related mortgage loans with relatively high interest rates. Excess interest occurs because more interest is required to be paid by the mortgagors than is necessary to pay the interest due to the securitization noteholders and the expenses of the securitization trust. If an underlying securitization trust were terminated as a result of the exercise of the related clean-up call or an event of default under the related indenture, we would not be entitled to any further payments in respect of excess interest. There can be no assurance that the holder of the clean-up call for each securitization trust will not exercise it at the earliest opportunity.

A rapid rate of principal payments on such mortgage loans would have the effect of accelerating payments in respect of principal collections to us, and a slow rate of payment would have the effect of decelerating these payments. Generally, we will not be entitled to receive the entire excess cash flow with respect to a securitized mortgage pool prior to the date on which the related overcollateralization target has been achieved or if a trigger event (such as delinquencies or realized losses reaching a specified percentage) has occurred and is continuing with respect to that mortgage pool. Realized losses on the related mortgage loans will have the effect of reducing the overcollateralization in the related mortgage pool, and therefore reduce the amount ultimately distributable to us, although the application of excess interest may restore a reduction in the overcollateralization amount. There can be no assurance that excess interest will be available for this purpose.

The terms of certain mortgage loans provide for payment by the related mortgagor of a prepayment charge in limited circumstances on certain prepayments. Any prepayment charges paid in respect to the mortgage loans in a mortgage pool will be used to make required payments by the related securitization trust, and any funds in excess thereof will be distributed to us. Generally, each prepayment charge only remains applicable with respect to the related mortgage loan for a limited period of time. In addition, under certain instances, the payment of any otherwise applicable prepayment charge may be waived by AHL, as the underlying servicer.

---

**Table of Contents**

***The securitized mortgage loans may include mortgage loans with LTVs in excess of 80%, which may present a greater risk of loss.***

A portion of the mortgage loans in each of our securitized mortgage pools had a mortgage loan-to-value ratio ( LTV ) at origination in excess of 80% and is not covered by a primary mortgage insurance policy. Mortgage loans with higher LTVs may present a greater risk of loss. There can be no assurance that the LTV of any mortgage loan determined at any time after origination is less than or equal to its original LTV.

***The overcollateralization requirement of each securitization trust will affect the rate and timing of distributions to be received by us.***

Each securitized mortgage pool is subject to an overcollateralization requirement. The required overcollateralization amount for each underlying securitization trust will be determined as set forth in the related underlying indenture and sale and servicing agreement. No payments will be received by us with respect to a mortgage pool until the then-applicable required overcollateralization amount has been reached and maintained.

The related required overcollateralization amount with respect to a securitization trust may be permitted to decrease, subject to certain conditions specified in the related indenture and sale and servicing agreement. If such conditions have been satisfied, collections of principal that would otherwise be distributed as a payment of principal to the related securitization noteholders will instead be received by us. Conversely, if at any time certain delinquency and/or loss levels are exceeded with respect to a mortgage pool, there will be a delay in the reduction of the related required overcollateralization amount or there may be an increase in the related required overcollateralization amount. There may be significant periods during which no or limited distributions will be made to us in respect of our retained interests in securitized mortgage pools.

***Our hedging strategies may not be successful in mitigating our risks associated with interest rates.***

We use various derivative financial instruments to provide a level of protection against interest rate risks, but no hedging strategy can protect us completely. When rates change, we expect to record a gain or loss on derivatives, which would be offset by an inverse change in the value of our securitized mortgage loans subject to portfolio based accounting, as reflected in the Interest Rate Simulation Sensitivity Analysis in the section entitled Market Risk in ITEM 7. Management's Discussion and Analysis of Financial Condition and Results of Operations. We cannot assure you, however, that our use of derivatives will offset the risks related to changes in interest rates. There have been periods, and it is likely that there will be periods in the future, during which we will not have offsetting gains or losses in mortgage loan values after accounting for our derivative financial instruments. The derivative financial instruments we select may not have the effect of reducing our interest rate risk. In addition, the nature and timing of hedging transactions may influence the effectiveness of these strategies. Poorly designed strategies, improperly executed transactions, or inaccurate assumptions could actually increase our risk and losses. In addition, hedging strategies involve transaction and other costs. We cannot assure you that our hedging strategy and the derivatives that we use will adequately offset the risk of interest rate volatility or that our hedging transactions will not result in losses. See discussion under Market Risk under ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

***The distributions to us may be subject to basis risk in the difference between One-Month LIBOR and Six-Month LIBOR.***

Certain of the underlying securitization trusts have been structured such that a group of adjustable-rate mortgage loans collateralize a class of variable-rate notes. These notes have interest rates based upon One-Month LIBOR, while the interest rates on the related mortgage loans are based upon Six-Month LIBOR, subject to periodic adjustments and limitations on such adjustments. In a rising interest rate environment, the interest rates on the notes may rise more quickly than the interest rates of the mortgage loans. As a consequence, cash flow resulting from excess interest on the mortgage loans, and accordingly, amounts distributable to us may be substantially reduced. The interest payments payable on the notes may be subject to an available funds cap rate. If a rising interest rate environment, or a disproportionately high rate of prepayments (including prepayments and collections upon defaults, liquidations) and realized losses on the mortgage loans in the related mortgage pool with relatively high interest rates, causes the interest rate on the related notes to equal the available funds cap rate applicable thereto, then the excess interest amount is generated by the portion of each underlying securitization trust represented by the principal balance of the related notes may be used to make a compensatory payment to noteholders.

The notes that are subject to basis risk shortfalls as described above will be entitled to recover the amount of any such shortfalls, with interest thereon, to the extent that excess cash flow or other amounts become available to fund such recovery. Any amounts paid directly or indirectly from excess cash flow to the securitization noteholders in respect of any such shortfalls will reduce the excess interest amounts that would otherwise be distributable to us and may reduce the amount of overcollateralization release that would otherwise be available to us and will therefore not be available to us.

## **Table of Contents**

Other underlying securitization trusts have been structured such that a group of fixed- and adjustable-rate mortgage loans collateralize a class of variable-rate notes. The cash flow distributed to us under this structure is also subject to the basis risk described above, to the extent of the adjustable-rate mortgage loans, and the basis risk created by issuing variable-rate notes collateralized by fixed-rate mortgage loans. As market interest rates rise, the interest rate on the senior notes rises, but the interest rate on the fixed-rate mortgage loans remains constant, thereby reducing the excess interest available for distribution to us.

***The geographic concentration of the mortgaged properties securing our securitized mortgage loans may create risks of greater losses associated with adverse conditions that may arise in areas of concentration.***

Our securitized mortgage loans have certain geographic concentrations in a number of states, which may present a greater risk of loss if conditions in those states become adverse. In these states, if the residential real estate market should experience an overall decline in property values after the dates of origination of the mortgage loans, the rates of delinquencies, foreclosures, bankruptcies and losses on the mortgage loans may increase over historical levels of comparable type mortgage loans, and may increase substantially. In addition, properties located in California and Florida may be more susceptible than homes located in other parts of the country to certain types of uninsured hazards, such as earthquakes, wildfires, hurricanes, floods, mudslides and other natural disasters. As of March 31, 2007, 18% and 15% of the unpaid principal amounts of the mortgage loans in our portfolio were secured by properties located in California and Florida, respectively.

***Our securitized mortgage loans are underwritten to standards that generally do not conform to the credit criteria required by Fannie Mae and Freddie Mac, and therefore may experience higher levels of delinquencies and losses.***

All of our securitized mortgage loans have been originated and underwritten by AHL. In general, AHL originates and acquires mortgage loans that do not meet the credit criteria required by Fannie Mae and Freddie Mac. These nonconforming mortgage loans may tend to exhibit higher levels of delinquency and loss than mortgage loans, which conform to the requirements of Fannie Mae and Freddie Mac. The interest rates and the LTVs for such mortgage loans are established at levels designed to compensate for and offset the increased delinquency, foreclosure and loss risks presented by such mortgage loans. No assurances can be given, however, that the mortgage loans in any underlying securitization trust will not exceed expected delinquency, foreclosure and loss levels and adversely affect the amount and value of the cash flow to be received by us.

***The diversification of the properties securing our interest in mortgage loans is limited, and the liquidation of a mortgage pool after the occurrence of an event of default could greatly reduce or even eliminate the amount distributable to us.***

Although our assets consists primarily of the right to receive cash flows from mortgage pools and we benefit from the diversification of risks associated with the mortgage pools, the mortgage pools contain mortgage loans originated or acquired by AHL under AHL's underwriting standards and serviced by AHL as servicer. Accordingly, any benefits arising from the diversification of the properties securing our interest in mortgage loans will be limited. Furthermore, there is no cross-collateralization between the underlying securitization trusts.

***We may be adversely affected by litigations to which we or Accredited may become a party.***

We are and may in the future become a defendant in lawsuits which seek to recover substantial amounts from us. No assurances can be given that we will be able to successfully defend all or any of such lawsuits, and adverse results in one or more of such lawsuits could have a material adverse effect on us. In addition, we could be adversely affected by litigation to which Accredited is a party.

***If we fail to maintain our status as a real estate investment trust, we will be subject to federal or state income tax on taxable income at regular corporate rates.***

We were organized to qualify for taxation as a real estate investment trust under the Internal Revenue Code of 1986, as amended (the Code). We have conducted, and intend to continue to conduct, our operations so as to qualify as a real estate investment trust. Qualification as a real estate investment trust involves the satisfaction of numerous requirements, some on an annual and some on a quarterly basis, established under highly technical and complex provisions of the Code for which there are only limited judicial and administrative interpretations and involves the determination of various factual matters and circumstances not entirely within our control. For instance, in order to qualify as a real estate investment trust, no more than 50% of the value of our outstanding shares of beneficial interest may be beneficially owned, directly or indirectly, by five or fewer individuals (as defined in the Code to include certain entities) (the Ownership Test) during the last six months of our taxable year. Furthermore, each year we must distribute to our shareholders at least 90% of our taxable income (the Annual Distribution Requirements). We cannot assure you that we will at all times satisfy these rules and tests.



**Table of Contents**

If we were to fail to qualify as a real estate investment trust in any taxable year, as a result of a determination that we failed to meet the Ownership Test, the Annual Distribution Requirement or any other requirement, we would be subject to federal and state income tax, including any applicable alternative minimum tax, on our taxable income at regular corporate rates. Moreover, unless entitled to relief under certain statutory provisions, we would also be disqualified from treatment as a real estate investment trust for the four taxable years following the year during which the qualification is lost. This treatment would reduce our net earnings and cash flow available for distribution to shareholders. Additionally, distributions to shareholders would no longer be required to be made by us. Accordingly, our failure to qualify as a real estate investment trust could have a material adverse impact on our financial results and the value of our Series A Preferred Shares.

Moreover, in order to satisfy the Ownership Test, our Declaration of Trust establishes certain ownership restrictions on our shares of beneficial interest. For example, no individual (as described above) may beneficially own more than 9.8% of our value. Even with this restriction, depending on the concentration of ownership of Accredited's stock and the relative value in our common and preferred shares, it is possible that AHL's ownership of our common shares would cause us to fail to satisfy the Ownership Test. In such a situation, the Declaration of Trust would require that the number of our common shares held by AHL which causes us to fail to satisfy the Ownership Test be transferred to a charitable trust at a price no greater than the fair market value of our common shares as of such date, and Accredited would have no future beneficial interest in such common shares (including the right to vote or receive dividends on such common shares).

***Our shareholders may be adversely affected by our ownership of residual interests in taxable mortgage pools.***

We have completed securitizations of mortgage loans using a taxable mortgage pool structure and have retained the residual interest in these securitizations. The U.S. Treasury Department has authority to issue regulations treating a portion of the income from a residual interest in a taxable mortgage pool held by a real estate investment trust as excess inclusion income as defined in Section 860E of the Internal Revenue Code. The U.S. Treasury Department has yet to exercise that authority. Under such circumstances, it is likely that the REIT's shareholders would be subject to tax on their allocable share of the REIT's excess inclusion income. If so, our shareholders generally would not be able to offset their share of excess inclusion income with any current, carryforward or carryback net operating losses. In addition, it is likely that tax exempt entities that own shares in us would be required to treat their allocable share of excess inclusion income as unrelated business taxable income. Further, any portion of our dividends paid to foreign shareholders that is allocable to excess inclusion income would not be eligible for exemption from the 30% withholding tax (or reduced treaty rate) on dividend income. Finally, if our shares are held or acquired by disqualified organizations as defined in Section 860E, then we would be subject to an entity level tax on the excess inclusion amount allocated to such shareholders, at the highest rate of tax imposed on corporations. If imposed, such entity level tax would be deductible to the REIT. It is possible that we will continue to use the taxable mortgage pool structure in our future securitizations.

***The early termination of an underlying securitization trust could substantially reduce or even eliminate the amount of distributions that would otherwise be received by us.***

*Upon exercise of clean-up call.* Each securitization trust is structured such that, when the aggregate outstanding principal balance of the notes has declined to a level less than or equal to a specified amount (typically 10%) of the original aggregate principal balance, then a specified party has the option to purchase the remaining mortgage loans from the trust, causing the securitization trust to call its outstanding notes and terminate the trust. The party holding this option is AHL, in the case of securitization transactions executed by AHL, and us, in the case of transactions executed by us. There can be no assurance that the holder of the clean-up call for each securitization trust will not exercise it at the earliest opportunity.

*Upon declaration of event of default.* In addition, the indenture with respect to each series of securitization notes issued by a securitization trust includes events of default which, if they occur and are not cured within the applicable cure period, entitle the related controlling party to declare an event of default and cause the trustee to liquidate the mortgage loans.

If a clean-up call were exercised or if a mortgage pool were liquidated as a result of and declaration of an event of default, we would only be entitled to receive that portion of the proceeds on the mortgage loans not required to make payment in full of the principal and accrued and unpaid interest to the securitization noteholders, plus any unpaid fees and expenses of the servicer and the trustees, and any unpaid amounts owed to the note insurer and swap provider. There can be no assurance that any such amount would not be substantially less than the amount that would otherwise be distributable to us had such clean-up call or liquidation not occurred.



---

## **Table of Contents**

### **Risks Relating to the Terms of REIT's Series A Preferred Shares**

*The timing and amount of contributions of additional assets to us by our parent are uncertain, and our existing assets may not generate sufficient funds to pay the preferred dividend.*

Our sole source of mortgage loans has been contributions from AHL, our parent. As noted above, AHL has substantially suspended U.S. lending operations, and it is uncertain when or if AHL will resume lending operations at a level which will generate the volume of mortgage loans necessary to cost-effectively execute further securitizations. Even if AHL does generate a sufficient volume of mortgage loans, AHL may not contribute loans to us for securitization because other conditions prerequisite to the execution of securitizations may not be available on cost-effective terms. The ratings agencies have increased the levels of credit enhancement required for securitizations of non-prime loans, and AHL's ratings as a servicer of mortgage loans have been downgraded and may be downgraded further, both of which factors will make it more difficult for us and AHL to execute further securitizations of non-prime mortgage loans. In addition, we intend to operate in a manner that will not subject us to regulation under the Investment Company Act; in order to satisfy the requirements for exemptive relief from regulation under the Investment Company Act, we may be subject to restrictions on our operations, including our ability to acquire certain types of mortgage assets. If we are unable to obtain additional mortgage assets from AHL or otherwise, our existing assets may not generate sufficient funds to pay the dividend on our Series A Preferred Shares.

*The Series A Preferred Shares rank subordinate to claims of our creditors and equally with any other parity shares we may issue, and the Series A Preferred Shareholders' ability to receive dividends or the liquidation preference is therefore limited.*

The Series A Preferred Shares rank subordinate to all claims of our existing and future creditors. As a result, upon any distribution to our creditors in a bankruptcy, liquidation or reorganization or similar proceeding, the holders of our indebtedness will be entitled to be paid in full in cash before any payment may be made to holders of the Series A Preferred Shares. We may incur substantial indebtedness in the future.

In addition, with the approval of a majority of our Board of Trustees and obtaining the approval of a majority of our independent trustees, we may issue authorized parity shares at any time in the future without your consent or approval. Accordingly, if:

we do not have funds legally available to pay full dividends on our Series A Preferred Shares and any other parity shares we may issue; or

we do not have funds legally available to pay the full liquidation value of our Series A Preferred Shares and any parity shares in the event of our liquidation, dissolution or winding up, then any funds that are legally available to pay such amounts will be paid pro rata to holders of our Series A Preferred Shares and any of our parity shares then outstanding.

*The guarantee of the Series A Preferred Shares is subordinate to claims of Accredited's creditors and effectively subordinated to the creditors of Accredited's subsidiaries.*

Accredited's guarantee of the Series A Preferred Shares ranks behind all of its existing and future indebtedness. As a result, upon any distribution to Accredited's creditors in a bankruptcy, liquidation or reorganization or similar proceeding, the holders of indebtedness of Accredited will be entitled to be paid in full in cash before any payment may be made to holders of the Series A Preferred Shares under the guarantee.

The guarantee also will effectively rank junior to all liabilities of Accredited's subsidiaries, including AHL. Accredited is a holding company and its assets consist primarily of investments in its subsidiaries. Substantially all of the consolidated liabilities of Accredited have been incurred by its subsidiaries. Therefore, Accredited's rights to participate in the distribution of assets of any subsidiary upon the latter's liquidation or reorganization will be subject to prior claims of the subsidiary's creditors, including trade creditors, except to the extent that Accredited may itself be a creditor with recognized claims against the subsidiary (in which case the claims of Accredited would still be subject to the prior claims of any secured creditor of such subsidiary and of any holder of indebtedness of such subsidiary that is senior to that held by Accredited).

The guarantee is an obligation exclusively of Accredited. Accredited's ability to make payments on the guarantee is dependent primarily upon the earnings of its subsidiaries and the distribution or other payment of such earnings to Accredited in the form of dividends, mortgage loans or advances and repayment of mortgage loans and advances from Accredited. The subsidiaries are separate and distinct legal entities and have no

## Edgar Filing: Accredited Mortgage Loan REIT Trust - Form 10-Q

obligation, contingent or otherwise, to pay any amounts due pursuant to the guarantee or to make any funds available therefore, whether by dividends, mortgage loans or other payments.

## **Table of Contents**

The payment of dividends, or the making of mortgage loans and advances to Accredited by its subsidiaries, may be subject to statutory or regulatory restrictions, is contingent upon the earnings of those subsidiaries and is subject to various business considerations.

At March 31, 2007, the guarantee would have been effectively subordinated to approximately \$7.4 billion of indebtedness, including securitization indebtedness but excluding intercompany indebtedness, of Accredited and debt obligations of its subsidiaries. Accredited and its subsidiaries may incur substantial additional indebtedness in the future.

***Holders of our Series A Preferred Shares have very limited voting rights and, except in limited circumstances, will not be able to elect trustees or influence other matters submitted to a vote of our shareholders.***

Although our Series A Preferred Shares have voting rights, these voting rights are very limited. All series of our preferred shares that provide for such voting rights will have the right to collectively in the aggregate cast 15% of the votes cast by shareholders on all matters put to our shareholders generally for a vote. This voting right will be allocated among the preferred shares according to their liquidation preference. The holders of the common shares will have the right to cast 85% of the votes on such matters. AHL currently holds all of our outstanding common shares of beneficial interest and, accordingly, controls enough voting power to determine the outcome of matters submitted to a vote of our shareholders, including the election of trustees.

Whenever dividends on any of the Series A Preferred Shares or any series of preferred shares ranking on a parity as to the payment of dividends with the Series A Preferred Shares shall be in arrears for six or more quarterly periods (whether consecutive or not), the holders of such Series A Preferred Shares (voting separately as a class with all other series of our preferred shares ranking on a parity with the Series A Preferred Shares as to the payment of distributions and the distribution of assets upon liquidation upon which like voting rights have been conferred and are exercisable) will be entitled to vote for the election of a total of two additional members of our Board of Trustees. In addition, the Series A Preferred Shares will have the right to participate in the vote of all matters put to the preferred shares voting as a class, such vote to be determined by reference to their liquidation preference.

All of our trustees and officers are also directors and/or officers of Accredited and may conduct our business in a manner that serves Accredited's interests better than the interests of holders of the Series A Preferred Shares.

***There may be adverse effects from Accredited's ownership of all of our common shares.***

Accredited is involved in virtually every aspect of our existence. AHL is the sole holder of our common stock, and, in the first quarter of 2007, AHL pledged all of our common stock as collateral for the Farallon Loan. AHL also acts as servicer of the securitized mortgage loans. In addition, all of our officers and trustees are also officers and/or directors of Accredited. As the holder of all of our outstanding common shares of beneficial interest, except in limited circumstances, AHL will have the right to elect all of our trustees, including our independent trustees.

Accredited may have interests which are not identical to ours. Consequently, conflicts of interest may arise with respect to transactions, including without limitation, our acquisition of mortgage loans from AHL; servicing of mortgage loans; future dispositions of mortgage loans; and the provision by AHL of advisory services to us. It is our intention and that of Accredited that any agreements and transactions between us, on the one hand, and Accredited and/or its affiliates, on the other hand, are fair to all parties and consistent with market terms, including the servicing of mortgage loans. However, there can be no assurance that such transactions will be on terms as favorable to us as those that could have been obtained from unaffiliated third parties.

***We may fail to qualify as a real estate investment trust, which would permit us to redeem the Series A Preferred Shares under certain circumstances.***

We intend to be owned, organized and operated so as to qualify as a real estate investment trust under the Internal Revenue Code. Although we believe that we will be owned and organized and will operate in such a manner, it is not certain that we will be able to remain qualified as a real estate investment trust for federal income tax purposes. Our qualification as a real estate investment trust depends on, among other factors, the distribution annually of at least 90% of our taxable income, determined before any deduction for dividends paid and excluding any net capital gains, the nature of our assets, the manner of our operation, our organization, our capital structure and the ownership of our equity. Qualification as a real estate investment trust involves the application of highly technical and complex tax law provisions for which there are only limited judicial or administrative interpretations and involves the satisfaction of various requirements not entirely within our control. No assurance can be given that new legislation, Treasury regulations, administrative interpretations or court decisions will not significantly change the tax laws with respect to qualification as a real estate investment trust or the federal income tax consequences of such qualification in a way that would have a material adverse affect on our ability to qualify as a real estate



---

**Table of Contents**

investment trust. Any such new legislation, Treasury regulation, interpretation or decision could be the basis of a tax event that would permit us to redeem our Series A Preferred Shares, subject to certain conditions, for the amount of the liquidation preference per share of our Series A Preferred Shares plus accrued and unpaid dividends to, but excluding, the redemption date.

Although we intend to be owned, organized and operated in a manner that allows us to qualify and remain qualified as a real estate investment trust, future economic, market, legal, tax or other considerations may cause us to determine that it is in our best interests and the best interests of holders of our common shares of beneficial interest and preferred shares to revoke our election to be treated as a real estate investment trust. Any such determination by us may be made without shareholder approval but, as long as any shares of the Series A Preferred Shares are outstanding, will require the prior approval of a majority of our independent trustees (as defined in the terms of our Series A Preferred Shares).

Recent changes as well as possible future changes to federal tax laws could make stock in non-REIT corporations more attractive to investors than stock in real estate investment trusts and thereby negatively affect the value of and market for the Series A Preferred Shares.

***We may redeem our Series A Preferred Shares upon the occurrence of a tax event or an investment company event, subject to additional conditions.***

At any time following the occurrence of a tax event or an investment company event, even if such tax event or investment company event occurs prior to September 30, 2009 (which would otherwise be the first day on which we could redeem the Series A Preferred Shares), we will have the right but not the obligation to redeem our Series A Preferred Shares in whole for an amount equal to the liquidation preference per share, plus accrued and unpaid dividends, if any, to, but excluding, the date of redemption, subject to certain additional conditions. The occurrence of a tax event or an investment company event will not, however, give a shareholder any right to require us to redeem our Series A Preferred Shares. A tax event will generally occur if we receive an opinion of counsel to the effect that, as a result of a judicial decision or official administrative pronouncement, ruling or regulatory procedure or as a result of changes in the tax laws, regulations or related official interpretations, there is a more than insubstantial risk that dividends with respect to our shares of beneficial interest will not be fully deductible by us or we will be subject to more than a de minimus amount of additional taxes or governmental charges. An investment company event generally will occur if we receive an opinion of counsel to the effect that there is more than an insubstantial risk that we are or will be considered an investment company within the meaning of the Investment Company Act as a result of any judicial decision, any pronouncement or interpretation, the adoption or amendment of any law, rule or regulation, any notice or announcement by any U.S. legislative body, court, governmental agency or regulatory authority, in each case after the initial issuance of Series A Preferred Shares.

***The ownership limitations and restrictions on transfer relating to the Series A Preferred Shares could have adverse consequences to us.***

In order to facilitate our compliance with the requirements to qualify as a real estate investment trust under the Internal Revenue Code, our Declaration of Trust contains certain ownership limitations and transfer restrictions relating to our Series A Preferred Shares. The Declaration of Trust provides that no person may own, or be deemed to own by virtue of the attribution provisions of the Internal Revenue Code, more than 9.8% (the Aggregate Share Ownership Limit) of the value of our outstanding common and preferred shares of beneficial interest. In addition, the Declaration of Trust further prohibits (a) any person from beneficially or constructively owning shares of beneficial interest of us that would result in us being closely held under Section 856(h) of the Internal Revenue Code or otherwise cause us to fail to qualify as a real estate investment trust and (b) any person from transferring our shares of beneficial interest if such transfer would result in our shares of beneficial interest being owned by fewer than 100 persons. Any person who acquires or attempts or intends to acquire beneficial or constructive ownership of our shares of beneficial interest that will or may violate any of the foregoing restrictions on transferability and ownership is required to give notice immediately to us and provide us with such other information as we may request in order to determine the effect of such transfer on our status as a real estate investment trust. The Aggregate Share Ownership Limit does not apply to the common shares owned, directly or indirectly, by AHL.

If any transfer of our shares of beneficial interest or any other event occurs which, if effective, would result in any person beneficially or constructively owning our shares of beneficial interest in excess or in violation of the above transfer or ownership limitations (a Prohibited Owner), that number of our shares of beneficial interest, the beneficial or constructive ownership of which otherwise would cause such person to violate such limitations (rounded to the nearest whole share) will be transferred to a charitable trust and in such event the Prohibited Owner will not be entitled to benefit economically from such shares, will not be entitled to rights to dividends in respect of such shares and will not possess any rights to vote or other rights attributable to such shares.

**Table of Contents**

Whether or not a holder of Series A Preferred Shares is or becomes a Prohibited Owner will depend both on the number of shares owned by such holder and the relative values of our common and preferred shares. Fluctuations in the relative value of our common shares, the Series A Preferred Shares and any other preferred shares then outstanding could cause a holder of Series A Preferred Shares to inadvertently become a Prohibited Owner, which could have negative economic and other consequences to such holder. Our common shares are not publicly traded and establishing their value may be difficult. If it were determined by the Internal Revenue Service, and subsequently upheld by a court or other administrative body that our valuation was unreasonable, and because of the valuation error we were to become closely held, we would cease to qualify as a real estate investment trust under the Internal Revenue Code and would be subject to corporate level tax.

***Our warehouse credit facilities contain covenants that restrict our operations and may inhibit our ability to grow our business and increase revenues.***

Our warehouse credit facilities contain extensive restrictions and covenants. If we fail to meet or satisfy any of these covenants, we would be in default under these agreements and our lenders could elect to declare all amounts outstanding under the agreements to be immediately due and payable, enforce their interests against collateral pledged under such agreements and restrict our ability to make additional borrowings. These agreements also contain cross-default provisions, so that if a default occurs under any one agreement, the lenders under our other agreements could also declare a default.

The covenants and restrictions that may interfere with our ability to obtain financing or engage in other business activities, and significantly harm our business, financial condition, liquidity and results of operations include, among other things:

minimum profitability;

liquidity and net worth requirements;

limitations on indebtedness to net worth ratios;

asset quality and mortgage loan performance tests;

inter-company dividends;

investments and acquisitions;

repurchase or redemption of capital stock;

mergers or consolidations or other changes of control;

mortgage loan attributes;

time periods for holding mortgage loans;

## Edgar Filing: Accredited Mortgage Loan REIT Trust - Form 10-Q

loss of servicer ratings;

maximum cumulative losses;

financial reporting requirements, including timely filing of reports required under the Securities Act;

delivery of audited financial statements and auditors' letter (without a going concern qualification); and

material adverse change restrictions.

These restrictions may interfere with our ability to obtain financing or to engage in other business activities, which may significantly harm our business, financial condition, liquidity and results of operations.

Our lenders have the ability to reasonably determine in their sole discretion whether a material adverse change has occurred and if they were to do so we would be in default under these facilities. There can be no assurance that our lenders will not determine that a material adverse change has occurred and cause us to be in default under these facilities. These agreements also contain cross-default provisions, so that if a default occurs under any one agreement, the lenders under our other agreements could also declare a default. Our lenders have the right to liquidate the collateral pledged under such agreements upon the occurrence of a default and there can be no assurance that the proceeds realized from such a sale would be an amount equal to what would be realized by a sale of the collateral in a non-liquidation setting.

**Table of Contents**

**Risks Related to the Proposed Merger of Accredited**

*Our business and the business of Accredited may be adversely impacted by Accredited's pending merger with Lone Star and if the pending merger is not consummated.*

Accredited has spent significant time and money preparing for the pending merger of Accredited with Lone Star. There are uncertainties and other factors that may affect Accredited's business and, indirectly, our business prior to consummation of the merger, including:

the outcome of any litigation and judicial actions that have been or may be instituted against Accredited and others relating to the merger agreement, including legislative action, referenda and taxation;

certain costs relating to the merger, such as legal, accounting and financial advisory fees, are payable by Accredited whether or not the merger is completed;

risks that the proposed transaction disrupts Accredited's and our current plans and operations, and the potential difficulties for employee retention as a result of the announcement of the merger; and

the effect of the announcement of the merger on Accredited's and our customer relationships, operating results and business generally.

There are also uncertainties and other factors that may affect the timing of the consummation of the merger, as well as if the merger will be consummated, including:

The outcome of Accredited's pending lawsuit against Lone Star for specific performance of Lone Star's obligations to close the tender offer and consummate the merger;

the occurrence of any event, change or other circumstances that could give rise to the termination of the merger agreement;

the inability to complete the merger due to the failure to obtain 50% of the shares through the tender offer, stockholder approval or the failure to satisfy other conditions to consummation of the merger;

the failure of the merger to close for any other reason;

risks that the proposed transaction disrupts Accredited's and our current plans and operations, and the potential difficulties for employee retention as a result of (a) any delay of the completion of the merger, or (b) the completion of the merger; and

the effect of the completion of the merger on Accredited's and our customer relationships, operating results and business generally.



**Table of Contents**

**ITEM 3. Quantitative and Qualitative Disclosures About Market Risk**

See discussion under Market Risk in ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

**ITEM 4. Controls and Procedures**

*Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures*

(a) Evaluation of Disclosure Controls and Procedures. In connection with the preparation of this Form 10-Q, as of March 31, 2007, an evaluation was performed under the supervision and with the participation of the Company's management, including the principal executive officer and principal financial officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act). Based on the evaluation, our management, including the principal executive officer and principal financial officer, concluded that the Company's disclosure controls and procedures were not effective in ensuring that reports we file under the Exchange Act occurred within time periods specified in SEC rules and forms as of March 31, 2007.

(b) Changes in Internal Controls. There were no changes in our internal control over financial reporting that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents**

**PART II**

**ITEM 1. Legal Proceedings**

Except as set forth below, we are not currently the subject of any litigation, and we are not currently involved in nor, to our knowledge, currently threatened with any material litigation with respect to the assets included in our portfolio.

In September 2007, we were named as a defendant under the consolidated, amended complaint in *Atlas v. Accredited Home Lenders Holding Co., et al.*, a class action pending in the United States District Court for the Southern District of California. The suit alleges violations of federal securities laws and originally named as defendants AHLHC and certain members of its senior management. Pursuant to the Private Securities Litigation Reform Act, five similar class actions were consolidated with the *Atlas* matter, and a lead plaintiff was selected. The consolidated, amended complaint was filed on August 24, 2007, and added as defendants the REIT and certain directors of AHLHC. However, as of September 17, 2007, we had not yet been served with the complaint. If we are served with the complaint, we intend to vigorously defend this matter. The ultimate outcome of this matter and the amount of liability, if any, which may result, is not presently determinable, but we do not believe it will have a material adverse effect on our business.

In July 2007 we were served with a complaint, *National Community Reinvestment Coalition ( NCRC ) v. Accredited Home Lenders Holding Company [sic], et al.*, brought in the United States District Court for the District of Columbia. The complaint alleges that we, AHL and AHLHC engaged in a practice of discriminating against African-Americans and Latinos by requiring minimum property values of \$100,000 on row homes for certain loan programs and prohibiting the use of row homes as collateral for certain other loan programs, without business justification for those restrictions. Plaintiff seeks compensatory and punitive damages, declaratory and injunctive relief, and recovery of attorneys' fees and costs of suit. There has been no ruling on the merits of plaintiff's claims, and, if served, we intend to vigorously defend this action. The ultimate outcome of this matter and the amount of liability, if any, which may result is not presently determinable, but we do not believe it will have a material adverse effect on our business.

Legal proceedings to which Accredited is a party are described in its Quarterly Report on Form 10-Q for the period ended March 31, 2007.

**ITEM 1A. Risk Factors**

We have provided updated risk factors in the section labeled "Risk Factors" in Part I, Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations.

**ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds**

None.

**ITEM 3. Defaults Upon Senior Securities**

None.

**ITEM 4. Submission of Matters to a Vote of Security Holders**

None.

**ITEM 5. Other Information**

None.

**ITEM 6. Exhibits**

For a list of exhibits filed with this Quarterly Report on Form 10-Q, refer to the Exhibit Index on page 44.



**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: September 18, 2007

ACCREDITED Mortgage Loan REIT Trust

BY:                    /s/ James A. Konrath  
                              James A. Konrath  
                              Chairman of the Board and Chief Executive Officer  
  
                              (Principal Executive Officer)

BY:                    /s/ Stuart D. Marvin  
                              Stuart D. Marvin  
                              Executive Vice President and Secretary  
  
                              (Principal Financial and Accounting Officer)

**Table of Contents**

**EXHIBIT INDEX**

- 3.1<sup>(1)</sup> Declaration of Trust of the Registrant.
- 3.2<sup>(2)</sup> Articles Supplementary to Declaration of Trust of Accredited Mortgage Loan REIT Trust dated August 11, 2004.
- 3.3<sup>(3)</sup> Articles Supplementary to Declaration of Trust of Accredited Mortgage Loan REIT Trust dated October 4, 2004.
- 3.4<sup>(1)</sup> Amended and Restated Bylaws of the Registrant.
- 3.5<sup>(4)</sup> Certificate of Incorporation of Accredited Acceptance Corp.
- 3.6<sup>(4)</sup> Bylaws of Accredited Acceptance Corp.
- 4.1<sup>(5)</sup> Amended and Restated Trust Agreement, dated as of January 30, 2007, among Accredited Home Lenders, Inc., as Sponsor, Accredited Mortgage Loan REIT Trust, as Depositor, and U.S. Bank Trust National Association, as Owner Trustee.
- 4.2<sup>(6)</sup> Indenture, dated as of January 1, 2007, between Accredited Mortgage Loan Trust 2007-1, a Delaware statutory trust acting through its owner trustee and Deutsche Bank National Trust Company, as Indenture Trustee.
- 10.1<sup>(5)</sup> Sale and Servicing Agreement, dated as of January 1, 2007, among Accredited Home Lenders, Inc., as Sponsor and Servicer, Accredited Mortgage Loan REIT Trust, as Depositor, Accredited Mortgage Loan Trust 2007-1, as Issuing Entity and Deutsche Bank National Trust Company, as the Indenture Trustee.
- 10.2<sup>(5)</sup> Master Agreement, dated January 30, 2007 between Accredited Mortgage Loan Trust 2007-1 and Credit Suisse International.
- 10.3<sup>(7)</sup> Loan Agreement, dated as of March 30, 2007, by and among Accredited Home Lenders, Inc., Accredited Mortgage Loan REIT Trust, the Lenders party thereto, Accredited Home Lenders Holding Co., and Farallon Capital Management, L.L.C.
- 31.1 Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350).
- 32.2 Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350).

- 
- (1) Filed with amendment number 2 to Registration Statement on Form S-3 (File No. 333-117484-01) dated August 5, 2004.
  - (2) Filed with Current Report on Form 8-K (File No. 000-50179) dated August 9, 2004.
  - (3) Filed with Current Report on Form 8-K (File No. 001-32275) dated October 1, 2004.
  - (4) Incorporated by Reference to Accredited Mortgage Loan REIT Trust's Registration Statement on Form S-3 (File No. 333-14703-02) filed on July 19, 2007.
  - (5) Incorporated by Reference to Accredited Mortgage Loan Trust 2007-1's Current Report on Form 8-K (File No. 333-129972-03) dated January 30, 2007.
  - (6) Incorporated by Reference to Accredited Mortgage Loan Trust 2007-1's Current Report on Form 8-K (File No. 333-129972-03) dated February 23, 2007.
  - (7) Incorporated by Reference to Accredited Mortgage Loan REIT Trust's Current Report on Form 8-K (File No. 001-32276) dated March 30, 2007.