JOHNSON & JOHNSON
Form 10-Q/A
May 15, 2003

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

FORM 10-Q/A

(X) Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended March 30, 2003

or

( ) Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the for the transition period from to

Commission file number 1-3215

JOHNSON & JOHNSON
(Exact name of registrant as specified in its charter)

NEW JERSEY	22-1024240
(State or other jurisdiction of Incorporation or organization)	(I.R.S. Employer Identification No.)

One Johnson & Johnson Plaza
New Brunswick, New Jersey 08933
(Address of principal executive offices)

Registrant's telephone number, including area code (732) 524-0400

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

On April 25, 2003, 2,968,820,767 shares of Common Stock, $1.00 par value, were outstanding.

EXPLANATORY NOTE:

This Form 10-Q/A amends Part I, Item 1 - Financial Statements: Consolidated Statements of Cash Flows for the fiscal three months ended March 30, 2003 and March 31, 2002 of the Quarterly Report on Form 10-Q filed by Johnson & Johnson on May 14, 2003. This statement is solely amending certain cash flow amounts related to financing activities. Net cash flows from operating activities was $2,036 million and Net cash used by financing activities was $1,009 million for the three month period ended March 30, 2003.

JOHNSON & JOHNSON AND SUBSIDIARIES

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Item 1 - Financial Statements

JOHNSON & JOHNSON AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Unaudited; Dollars in Millions)

ASSETS

	March 30, 2003	December 29, 2002
Current Assets:		
Cash and cash equivalents	$ 3,061	2,894
Marketable securities	4,786	4,581
Accounts receivable, trade, less allowances for doubtful accounts $188(2002 - $191)	5,836	5,399
Inventories (Note 4)	3,541	3,303
Deferred taxes on income	1,388	1,419
Prepaid expenses and other receivables	1,859	1,670
Total current assets	20,471	19,266
Marketable securities, non-current	121	121
Property, plant and equipment, at cost	14,899	14,314
Less accumulated depreciation	6,100	5,604
	8,799	8,710
Intangible assets, gross (Note 5)	11,647	11,355
Less accumulated amortization	2,222	2,109
Intangible assets, net	9,425	9,246
Deferred taxes on income	286	236
Other assets	2,892	2,977
Total assets	$41,994	40,556

See Notes to Consolidated Financial Statements

JOHNSON & JOHNSON AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(Unaudited; Dollars in Millions)

LIABILITIES AND SHAREHOLDERS' EQUITY

	March 30, 2003	December 29, 2002
Current Liabilities:		
Loans and notes payable	$ 2,103	2,117
Accounts payable	3,077	3,621
Accrued liabilities	4,248	3,820
Accrued salaries, wages and commissions	691	1,181
Taxes on income	1,338	710
Total current liabilities	11,457	11,449
Long-term debt	2,004	2,022
Deferred tax liability	573	643
Employee related obligations	2,005	1,967
Other liabilities	1,919	1,778
Shareholders' equity:		
Preferred stock - without par value (authorized and unissued 2,000,000 shares)	-	-
Common stock - par value $1.00 per share (authorized 4,320,000,000 shares; issued 3,119,842,000 shares)	3,120	3,120
Note receivable from employee stock ownership plan	(18)	(25)
Accumulated other comprehensive income (Note 8)	(818)	(842)
Retained earnings	27,852	26,571
	30,136	28,824
Less common stock held in treasury, at cost (150,951,000 & 151,547,000 shares)	6,100	6,127
Total shareholders' equity	24,036	22,697
Total liabilities and shareholders' equity	$41,994	40,556

See Notes to Consolidated Financial Statements

JOHNSON & JOHNSON AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF EARNINGS
(Unaudited; dollars & shares in millions
except per share figures)

	Fiscal Quarter Ended			
	March 30, 2003	Percent to Sales	March 31, 2002	Percent to Sales
Sales to customers (Note 6)	$9,821	100.0	8,743	100.0
Cost of products sold	2,722	27.7	2,457	28.1
Gross Profit	7,099	72.3	6,286	71.9
Selling, marketing and administrative expenses	3,253	33.1	2,843	32.5
Research expense	936	9.5	831	9.5
Purchased in-process research and development	18	.2	-	-
Interest income	(38)	(.4)	(76)	(.9)
Interest expense, net of portion capitalized	38	.4	34	.4
Other (income)expense, net	(37)	(.3)	33	.4
	4,170	42.5	3,665	41.9
Earnings before provision for taxes on income	2,929	29.8	2,621	30.0
Provision for taxes on income (Note 3)	859	8.7	787	9.0
NET EARNINGS	$2,070	21.1	1,834	21.0
NET EARNINGS PER SHARE (Note 7)				
Basic	$ .70		.60	
Diluted	$ .69		.59	
CASH DIVIDENDS PER SHARE	$ .205		.18	
AVG. SHARES OUTSTANDING				
Basic	2,968.4		3,042.0	
Diluted	3,018.5		3,115.4	

See Notes to Consolidated Financial Statements

JOHNSON & JOHNSON AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited; Dollars in Millions)

	Fiscal Quarter Ended March 30, 2003	March 31, 2002
CASH FLOWS FROM OPERATIONS		
Net earnings	$ 2,070	1,834
Adj. to reconcile net earnings to cash flows:		
Depreciation and amortization of property and intangibles	446	412
Purchased in-process research and development	18	-
Accounts receivable reserves	(5)	(13)
Changes in assets and liabilities, net of effects from acquisition of businesses:		
Increase in accounts receivable	(366)	(139)
Increase in inventories	(181)	(128)
Changes in other assets and liabilities	54	(31)
NET CASH FLOWS FROM OPERATING ACTIVITIES	2,036	1,935
CASH FLOWS FROM INVESTING ACTIVITIES		
Additions to property, plant and equipment	(408)	(350)
Proceeds from the disposal of assets	3	18
Acquisition of businesses, net of cash acquired	(258)	(28)
Purchases of investments	(1,634)	(1,689)
Sales of investments	1,417	2,023
Other	(17)	(58)
NET CASH USED BY INVESTING ACTIVITIES	(897)	(84)
CASH FLOWS FROM FINANCING ACTIVITIES		
Dividends to shareholders	(609)	(549)
Repurchase of common stock	(339)	(1,899)
Proceeds from short-term debt	221	272
Retirement of short-term debt	(354)	(156)
Proceeds from long-term debt	2	17
Retirement of long-term debt	(20)	(12)
Proceeds from the exercise of stock options	90	164
NET CASH USED BY FINANCING ACTIVITIES	(1,009)	(2,163)
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	37	(9)
INCREASE(DECREASE) IN CASH AND CASH EQUIVALENTS	167	(321)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	2,894	3,758
CASH AND CASH EQUIVALENTS,		

END OF PERIOD	$ 3,061	3,437
ACQUISITION OF BUSINESSES		
Fair value of assets acquired	285	39
Fair value of liabilities assumed	(27)	(11)
Net cash paid for acquisitions	$ 258	28

See Notes to Consolidated Financial Statements

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - The accompanying unaudited interim financial statements and related notes should be read in conjunction with the Consolidated Financial Statements of Johnson & Johnson and Subsidiaries (the "Company") and related notes as contained in the Annual Report on Form 10-K for the fiscal year ended December 29, 2002. The unaudited interim financial statements include all adjustments (consisting only of normal recurring adjustments) and accruals necessary in the judgment of management for a fair presentation of such statements.

NOTE 2 - FINANCIAL INSTRUMENTS

As of March 30, 2003 the balance of deferred net losses on derivatives included in accumulated other comprehensive income was $89 million after-tax. For additional information, see Note 8. The Company expects that $89 million will be reclassified into earnings over the next 12 months as a result of transactions that are expected to occur over that period. The amount ultimately realized in earnings will differ as foreign exchange rates change. Realized gains and losses are ultimately determined by actual exchange rates at maturity of the derivative. Transactions with third parties will cause the amount in accumulated other comprehensive income to affect net earnings. The maximum length of time over which the Company is hedging is 15 months.

For the fiscal quarter ended March 30, 2003 the net impact of the hedges' ineffectiveness to the Company's financial statements was insignificant. For the fiscal quarter ended March 30, 2003 the Company recorded a net gain of $5 million (after-tax) in the "other (income) expense, net" category of the consolidated statement of earnings, representing the impact of discontinuance of cash flow hedges because it is probable that the originally forecasted transactions will not occur by the end of the originally specified time period.

Refer to Note 8 for disclosures of movements in Accumulated Other Comprehensive Income.

NOTE 3 - INCOME TAXES

The effective income tax rates for the first fiscal three months of 2003 and 2002 were 29.3% and 30.0%, respectively, as compared to the U.S. federal statutory rate of 35%. The difference from the statutory rate was primarily the result of subsidiaries manufacturing in Ireland under an incentive tax rate effective through the year 2010 and domestic subsidiaries operating in Puerto Rico under a tax incentive grant expiring in 2014.

NOTE 4 - INVENTORIES
(Dollars in Millions)

	March 30, 2003	Dec. 29, 2002
Raw materials and supplies	$ 896	835
Goods in process	860	803
Finished goods	1,785	1,665
	$ 3,541	3,303

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NOTE 5 - INTANGIBLE ASSETS

Effective the beginning of fiscal year 2002 in accordance with SFAS No. 142, the Company discontinued the amortization relating to all existing goodwill and indefinite lived intangible assets. Intangible assets that have finite useful lives continued to be amortized over their useful lives. SFAS No. 142 requires that goodwill and non-amortizable intangible assets be assessed annually for impairment. The required initial assessment was completed at June 30, 2002 and no impairment was determined. This initial impairment assessment was updated in the fourth quarter of 2002 and no impairment was determined. Future impairment tests will be performed in the fourth quarter, annually.

(Dollars in Millions)

	March 30, 2003
Goodwill-gross	$ 5,451
Less accumulated amortization	668
Goodwill - net	4,783
Trademarks (non-amortizable)- gross	1,027
Less accumulated amortization	132
Trademarks (non-amortizable)- net	895
Patents and trademarks	2,105
Less accumulated amortization	589
Patents and trademarks - net	1,516
Other amortizable intangibles - gross	3,064
Less accumulated amortization	833
Other intangibles - net	2,231
Total intangible assets - gross	11,647
Less accumulated amortization	2,222
Total intangibles - net	$ 9,425

Goodwill as of March 30, 2003 as allocated by segment of business is as follows:

(Dollars in Millions)

	Consumer	Pharm	Med. Dev & Diag	Total
Goodwill, net of accumulated amortization at December 29, 2002	821	244	3,588	4,653
Acquisitions	-	76	34	110
Translation & Other	18	7	(5)	20
Goodwill at Mar. 30, 2003	839	327	3,617	4,783

The weighted average amortization periods for patents and trademarks and other intangible assets were 16 years and 18 years, respectively. The amortization expense of amortizable intangible assets for the fiscal year ended December 29, 2002 was $405 million pre-tax and the estimated amortization expense for the five succeeding years approximates $425 million pre-tax, per year, respectively.

NOTE 6 - SEGMENTS OF BUSINESS AND GEOGRAPHIC AREAS

(Dollars in Millions)

SALES BY SEGMENT OF BUSINESS

	Fiscal First Quarter 2003	2002	Percent Change
Consumer			
Domestic	$ 1,000	900	11.1
International	791	704	12.4
	1,791	1,604	11.7%
Pharmaceutical			
Domestic	$ 3,263	2,958	10.3
International	1,403	1,223	14.7
	4,666	4,181	11.6%
Med Dev & Diag			
Domestic	$ 1,748	1,663	5.1
International	1,616	1,295	24.8
	3,364	2,958	13.7%
Domestic	$ 6,011	5,521	8.9
International	3,810	3,222	18.2
Worldwide	$ 9,821	8,743	12.3%

OPERATING PROFIT BY SEGMENT OF BUSINESS

	Fiscal First Quarter 2003	2002	Percent Change
Consumer	$ 413	315	31.1

Pharmaceutical	1,859	1,664	11.7
Med. Dev. & Diag.	731	662	10.4
Segments total	3,003	2,641	13.7
Expenses not allocated to segments	(74)	(20)	
Worldwide total	$ 2,929	2,621	11.8%

SALES BY GEOGRAPHIC AREA

	Fiscal First Quarter 2003	2002	Percent Change
U.S.	$ 6,011	5,521	8.9
Europe	2,218	1,765	25.7
Western Hemisphere Excluding U.S.	472	481	(1.9)
Asia-Pacific, Africa	1,120	976	14.8
Total	$ 9,821	8,743	12.3%

NOTE 7 - EARNINGS PER SHARE

The following is a reconciliation of basic net earnings per share to diluted net earnings per share for the fiscal three months ended March 30, 2003 and March 31, 2002.

(Shares in Millions)

	Fiscal Quarter Ended March 30, 2003	March 31, 2002
Basic net earnings per share	$ .70	.60
Average shares outstanding - basic	2,968.4	3,042.0
Potential shares exercisable under stock option plans	179.6	204.1
Less: shares which could be repurchased under treasury stock method	(144.4)	(150.9)
Convertible debt shares	14.9	20.2
Adjusted average shares outstanding - diluted	3,018.5	3,115.4
Diluted earnings per share	$ .69	.59

Diluted earnings per share calculation included the dilution effect of convertible debt that was offset by the related decrease in interest expense of $4 million each for the first fiscal quarter ended March 30, 2003 and March 31, 2002, respectively.

Diluted earnings per share excluded 46.6 million and .2 million shares related to options for the first fiscal quarter ended March 30, 2003 and March 31, 2002, respectively as the exercise price per share of these options was greater than the average market value, resulting in an anti-dilutive effect on diluted earnings per share.

NOTE 8 - ACCUMULATED OTHER COMPREHENSIVE INCOME

The total comprehensive income for the fiscal three months ended March 30, 2003 was $2,094 million, compared with $1,719 million for the same period a year ago. Total comprehensive income included net earnings, net unrealized currency gains and losses on translation, net unrealized gains and losses on available for sale securities, pension liability adjustments and net gains and losses on derivative instruments qualifying and designated as cash flow hedges. The following table sets forth the components of accumulated other comprehensive income.

	For. Cur. Trans.	Unrld Gains/ (Losses) on Sec	Pens Liab Adj.	Gains/ (Losses) on Deriv & Hedg	Total Accum Other Comp Inc/(Loss)
December 29, 2002	$ (707)	(2)	(33)	(100)	(842)
2003 Three Months changes					
Net change associated to current period hedging transactions	-	-	-	(6)	
Net amount reclassed to net earnings	-	-	-	17*	
Net Three Months changes	18	(5)	-	11	24
March 30, 2003	$ (689)	(7)	(33)	(89)	(818)

Note: All amounts, other than foreign currency translation, are net of tax. Foreign currency translation adjustments are not currently adjusted for income taxes, as they relate to permanent investments in non-US subsidiaries.

*Primarily offset by changes in value of the underlying transactions.

NOTE 9 - MERGERS & ACQUISITIONS

On January 29, 2003, Johnson & Johnson acquired the assets of Orquest, Inc., a privately held biotechnology company focused on developing biologically-based implants for orthopaedics spine surgery. Orquest's principal product, HEALOS Bone Graft Material, is designed to reduce the time and pain associated with standard bone graft harvesting and represents a therapeutic advance for patients requiring bone graft material for spine fusion or other surgery.

On February 10, 2003, Johnson & Johnson acquired Orapharma, Inc., a specialty pharmaceutical company focused on the development and commercialization of unique therapeutics. Orapharma's initial product, ARESTIN, is the first locally administered, time-released antibiotic encapsulated in microspheres that controls the germs that can cause periodontal disease. The transaction was valued at approximately $85 million, net of cash. On March 28, 2003, Johnson & Johnson acquired 3-Dimensional Pharmaceuticals, Inc., a company with a technology platform focused on the discovery and development of potential new drugs in early stage development for the treatment of cardiovascular disorders, oncology and inflammation. The transaction was valued at approximately $88 million, net of cash. The Company incurred a pre-tax charge for in-process research and development (IPR&D) of approximately $7 million.

The disclosure requirements of SFAS No. 141, "Business Combinations" and SFAS No. 142, "Goodwill and Other Intangible Assets" are not provided as the impact of these acquisitions did not have a material effect on the Company's results of operations, cash flows or financial position.

During the first quarter, Johnson & Johnson also announced a definitive agreement to acquire Scios, Inc., a biopharmaceutical company with a marketed product for cardiovascular disease and research projects focused on auto-immune diseases. Scios' product NATRECOR is a novel agent approved for congestive heart failure and has several significant advantages over existing therapies. The transaction, valued at approximately $2.4 billion, net of cash, was completed on April 29, 2003. The purchase price allocation is still in process and is not yet available. The Company expects to incur a pre-tax charge for In-Process Research & Development in the second quarter of 2003 in the range of between $700 and $800 million.

On May 6, 2003, the Company announced a definitive agreement to acquire Link Spine Group, Inc., a privately owned corporation that will provide the Company with exclusive worldwide rights to the SB Charite Artificial Disc for the treatment of spine disorders. Under the terms of the agreement, the Company will pay a $325 million upfront payment with further contingent payments due upon achievement of regulatory and other milestones. The transaction is expected to close in the second quarter of 2003 and the Company anticipates an IPR&D charge of approximately $175 million to be incurred in connection with this acquisition.

NOTE 10 - PRO FORMA STOCK BASED COMPENSATION

At March 30, 2003, the Company had 24 stock-based employee compensation plans. The Company accounted for those plans under the recognition and measurement principles of Accounting Principle Board Opinion No. 25 "Accounting for Stock Issued to Employees" and its related Interpretations. Compensation costs were not recorded in net income for stock options, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant.

As required by SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure - an amendment of FASB Statement No. 123," the following table shows the estimated effect on net income and earnings per share if the Company had applied the fair value recognition provision of SFAS No. 123, "Accounting for Stock-Based Compensation," to stock-based employee compensation.

(Dollars in Millions Except Per Share Data)	March 30, 2003	March 31, 2002
Net income, as reported	2,070	1,834
Less:		
Compensation expense(1)	85	73
Pro forma	1,985	1,761
Earnings per share:		
Basic - as reported	$.70	$.60
- pro forma	.67	.58
Diluted - as reported	$.69	$.59
- pro forma	.66	.57

(1) Determined under fair value based method for all awards, net of tax.

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NOTE 11 - LEGAL PROCEEDINGS

The information called for by this footnote is incorporated herein by reference to Item 1 ("Legal Proceedings") included in Part II of this Report on Form 10-Q.

Item 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Operating Results

Sales

For the first fiscal quarter of 2003, worldwide sales were $9.8 billion, an increase of 12.3% over 2002 fiscal first quarter sales of $8.7 billion. The impact of foreign currencies accounted for 4.2% of the total reported increase of 12.3% over the same period a year ago.

Sales by domestic companies were $6.0 billion in the first fiscal quarter of 2003, which represented an increase of 8.9%. Sales by international companies were $3.8 billion, which represented an increase of 18.2% of which 11.3% was due to currency fluctuations.

For geographic areas throughout the world, sales increased 25.7% in Europe and 14.8% in Asia-Pacific/Africa but decreased 1.9% in the Western Hemisphere (excluding the U.S.) for the quarter.

Consumer segment sales in the quarter were $1.8 billion, an increase of 11.7% over the same period a year ago with 9.6% of operational growth with a positive currency impact of 2.1%. Domestic sales increased by 11.1% while international sales gains of 12.4% included a positive currency impact of 4.9%. Consumer sales achieved strong growth in skin care products (NEUTROGENA(r), CLEAN & CLEAR(r) and AVEENO(r)) and SPLENDA(r) sweetener products as well as broad-based growth in the Consumer Pharmaceuticals and Wound Care franchises.

Pharmaceutical segment sales in the quarter were $4.7 billion, an increase of 11.6% over the same period a year ago with 7.8% of this change due to operational increases and the remaining 3.8% increase related to the positive impact of currency. The domestic Pharmaceutical sales increase was 10.3% and the growth in international Pharmaceutical sales was 14.7% which included 13.0% related to the positive impact of currency.

Sales growth reflects the strong performance of REMICADE(r), a treatment for rheumatoid arthritis and Crohn's disease; RISPERDAL(r), an antipsychotic medication; DURAGESIC(r), a transdermal patch for chronic pain, and TOPAMAX(r), an anti-epileptic medication. The rate of growth of PROCRIT, a product for the treatment of anemia, had slowed versus recent trends due to the entry of a new competitor. PROCRIT, while still the market leader, has experienced a share decline. The competitive use of discounts and extended payment dating has moved market focus from total market development to a focus on share acquisition. The Company's positioning on PROCRIT continues to focus on the clinical benefits of PROCRIT.

The rate of growth of EPREX (epoetin alfa) experienced a sharp decline versus the prior year due to rare reports of Pure Red Cell Aplasia (PRCA) in chronic renal failure (CRF) patients when EPREX was administered subcutaneously. The Company has implemented steps to ensure that health care providers use the safest method of administering EPREX. These actions included the education of health care providers and patients in the proper handling of EPREX to preserve product integrity and a label change recommending intravenous versus subcutaneous dosing in chronic renal failure. The data available through the end of the year 2002 suggested that the incidence rate of PRCA had stabilized.

During the first quarter of 2003, the Company announced and completed the acquisition of 3-Dimensional Pharmaceuticals, Inc., a company with a technology platform focused on the discovery and development of potential new drugs in early stage development for the treatment of cardiovascular disorders, oncology and inflammation. The transaction was valued at $88 million, net of cash and resulted in an in-process research and development (IPR&D) charge of approximately $7 million. Also during the quarter, the Company acquired Orapharma, Inc., a specialty pharmaceutical company focused on the development and commercialization of unique therapeutics. Orapharma's initial product, ARESTIN, is the first locally administered, time-released antibiotic encapsulated in microspheres that controls the germs that can cause periodontal disease. The transaction was valued at approximately $85 million, net of cash.

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The Company also received U.S. Food and Drug Administration (FDA) approval for REMICADE (infliximab) for the additional indication of long-term treatment of fistulizing Crohn's disease, a chronic inflammatory bowel disorder that commonly affects the lower part of the small and large intestine, as well as FLEXERIL (cyclobenzaprine HCI) 5 mg tablets for the treatment of muscle spasm associated with painful musculoskeletal conditions. In April 2003, the Company received FDA approval for RISPERDAL M-TAB (risperidone), a fast dissolving form of the schizophrenia medication that dissolves in seconds when placed in the mouth.

Worldwide sales in the first fiscal quarter of 2003 of $3.4 billion in the Medical Devices & Diagnostics segment represented an increase of 13.7% over the same period a year ago with currency accounting for 5.7% of the sales growth. Domestic sales were up 5.1% and the international sales increase of 24.8% over the same period a year ago included a currency impact of 13.1%.

Strong sales growth was achieved in several franchises within this segment: DePuy's orthopaedic joint reconstruction and spinal products; Ethicon's wound care, and women's health products; and Ethicon Endo-Surgery's minimally invasive surgical products.

In the first quarter of 2003, Cordis sales increased by 14% versus the same period a year ago. Sales in the U.S. however, declined by approximately 14%, primarily attributable to a significant decline in coronary stent sales. In preparation for the launch of the CYPHER drug eluding stent, the Company has been working with customers to reduce their inventories of bare metal stents.

On April 24, 2003, the Company received approval from the FDA to market the CYPHER Sirolimus-eluting coronary stent, making it the first U.S. approved combination drug device intended to help reduce restenosis or reblockage of a treated coronary artery. The Company began shipping the product immediately after approval with the objective to provide access to as many patients and customers as soon as possible.

During the quarter, the Company completed the acquisition of Orquest, Inc., a privately held biotechnology company focused on developing biologically-based implants for orthopaedics and spine surgery. Orquest's principal product, HEALOS Bone Graft Material, is designed to reduce the time and pain associated with standard bone graft harvesting and represents a therapeutic advance for patients requiring bone graft material for spine fusion or other surgery.

Gross Profit

Gross profit margin in the first fiscal quarter of 2003 was 72.3%, an improvement of 0.4% over the gross profit margin in the same period a year ago of 71.9%. The improvement in gross profit margin was primarily related to ongoing improvement related to cost control efforts.

Selling, General and Administrative Expenses

Consolidated selling, general and administrative expenses increased 14.4% over the same period a year ago. Selling, general and administrative expenses as a percent to sales were 33.1% versus 32.5% for the same period a year ago. The increase was primarily due to an increase in spending for a sales force expansion in the Pharmaceutical segment and pre-launch spending in anticipation of the CYPHER stent approval.

In-Process Research & Development

In the fiscal first quarter of 2003, the Company recorded in-process research & development (IPR&D) charges of $15 million after-tax ($18 million before tax) related to acquisitions. These acquisitions included Orquest, Inc., a privately-held biotechnolgy company focused on developing biologically-based implants for orthopaedics spine surgery and 3-Dimensional Pharamceuticals, Inc., a company with a technology platform focused on the discovery and development of potential new drugs in early stage development for the treatment of cardiovascular diseases, oncology and inflammation.

Interest (Income) Expense

Interest income decreased in the first fiscal quarter of 2003 as compared to the same period a year ago due primarily to the continuing decline in U.S. interest rates. Interest expense in the first fiscal quarter of 2003 remained relatively constant as there were no significant changes in average debt balances.

Other (Income) Expense, Net

Other (income) expense included gains and losses related to the sale and write-down of certain equity securities of the Johnson & Johnson Development Corporation, losses on the disposal of fixed assets, currency gains & losses, minority interests, litigation settlement expense as well as royalty income. The favorable change of $70 million in other (income) expense was due primarily to a lower level of one-time expenses in 2003 as compared to the same period a year ago. The most significant factors affecting the year-on-year comparisons were reductions in 2003 in the write-down of equity securities of Johnson & Johnson Development Corporation and a current year non-recurring increase in royalty income for the quarter.

Earnings Before Provision for Taxes on Income

Consolidated earnings before provision for taxes on income increased 11.8% versus the same period a year ago. The increase was due primarily to volume growth, improved gross profit margins offset by increases in spending in selling, marketing and administrative expenses due to sales force expansion and pre-launch spending in anticipation of the CYPHER stent approval.

Operating profit by segment

Consumer segment operating profit increased 31.1% over the same period a year ago and reflects an operating profit as a percent to sales improvement of 3.5%. The improvement was due primarily to volume growth, leveraging of selling, promotion and administrative expenses offset by increased expenditures in advertising. Pharmaceutical segment operating profit increased 11.7% over the same period a year ago and its operating profit as a percent to sales was the same percent for the same period a year ago. The Pharmaceutical segment operating profit was negatively impacted by the cost of IPR&D related to 3-Dimensional Pharmaceuticals, Inc., acquisition and an increase in spending related to a sales force expansion.

Medical Devices & Diagnostics segment operating profit increased 10.4% over the same period a year ago and reflects an operating profit as a percent to sales decline of .7%. The margin decline was primarily due to pre-launch spending in anticipation of the CYPHER stent approval. Operating profit also includes the IPR&D associated with the acquisition of Orquest, Inc.

Provision For Taxes on Income

The effective income tax rates for the first fiscal three months of 2003 and 2002 are 29.3% and 30.0%, respectively, as compared to the U.S. federal statutory rate of 35%. The difference from the statutory rate was primarily the result of subsidiaries manufacturing in Ireland under an incentive tax rate effective through the year 2010 and domestic subsidiaries operating in Puerto Rico under a tax incentive grant expiring in 2014.

Net Income and Earnings Per Share

Worldwide net earnings for the first fiscal quarter of 2003 were $2.1 billion, reflecting a 12.9% increase over 2002. Worldwide net earnings per share for the first fiscal quarter of 2003 equaled $.69 per share, an increase of 16.9% from the $.59 net earnings per share in the same period a year ago.

Cash Flows and Liquidity

Cash generated from operations and selected borrowings provided the major sources of funds for the growth of the business, including working capital, capital expenditures, acquisitions, share repurchases, dividends and debt repayments. Cash and current marketable securities were $7.8 billion at the end of the first fiscal quarter of 2003 as compared with $7.5 billion at year-end 2002.

Cash generated from operations amounted to $2.0 billion in the first fiscal quarter of 2003 as compared to $1.9 billion for the same period a year ago.

Capital Expenditures

Capital expenditures in the first fiscal quarter of 2003 increased to $.4 billion or 16.6% over the same period a year ago. The increase was due primarily to expansion of manufacturing facilities to support new and existing products, investments in support of research facilities and investments in information systems across all business segments.

Dividends

On April 24, 2003, the Board of Directors declared a regular cash dividend of $0.24 per share, payable on June 10, 2003 to shareholders of record as of May 20, 2003. This represented an increase of 17.1% and was the 41st consecutive year of cash dividend increases. The Company expects to continue the practice of paying regular cash dividends.

Financial Position & Capital Resources

Total Assets & Returns

Total assets increased $1.4 billion or 3.5% in the first fiscal quarter of 2003 versus year-end 2002. Net intangible assets in the first fiscal quarter of 2003 increased 1.9% over year-end 2002 and represented 22.4% of total assets versus 22.8% of total assets at year-end 2002. Net property, plant and equipment increased to $8.8 billion or 1.0% and represented 21.0% of total assets versus 21.5% of total assets at year-end 2002. Shareholders' equity per share at the end of the first fiscal quarter of 2003 was $8.10 compared with $7.65 at year-end 2002, an increase of 5.9%.

Financing & Market Risk

Total borrowings at the end of the first fiscal quarter of 2003 was $4.1 billion, unchanged from year-end 2002. For the first fiscal quarter of 2003, net cash (cash and current marketable securities net of debt) was $3.7 billion. At year-end 2002, net cash (cash and current marketable securities net of debt) was $3.3 billion. Total debt represented 14.6% of total capital (shareholders' equity and total debt) for the first fiscal quarter of 2003 and 15.4% of total capital at year-end 2002. For the period ended March 30, 2003, there were no material cash commitments. In association with the purchase of Scios, Inc., the Company issued approximately $2.2 billion of commercial paper during April of 2003.

New Accounting Standards

In June 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations." The Company adopted this standard in 2003 that was effective for fiscal years beginning after June 15, 2002 and it has not had a material impact on the Company's results of operations, cash flows or financial position. In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" which was effective for exit or disposal activities that are initiated after December 31, 2002. The Company adopted SFAS No. 146 in the first quarter of 2003 and it has not had a material effect on the Company's results of operations, cash flows or financial position.

On November 25, 2002, the FASB issued FASB Interpretation No. 45 (FIN 45), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, an interpretation of FASB Statements No. 5, 57 and 107 and Rescission of FASB Interpretation No. 34." FIN 45 clarified the requirements of FASB Statement No. 5, "Accounting for Contingencies," relating to the guarantor's accounting for, and disclosure of, the issuance of certain types of guarantees. The disclosure requirements of FIN 45 are effective for financial statements of interim or annual periods that end after December 15, 2002 and have been adopted by the Company. There is no disclosure required for the first fiscal quarter of 2003. The provisions for initial recognition and measurement are effective on a prospective basis for guarantees that are issued or modified after December 31, 2002, irrespective of the guarantor's year-end. FIN 45 required that upon issuance of a guarantee, the entity must recognize a liability for the fair value of the obligation it assumes under that guarantee. The Company's adoption of FIN 45 in 2003 has not had a material effect on the Company's results of operations, cash flows or financial position.

In January 2003, the FASB issued FIN 46, "Consolidation of Variable Interest Entities - an interpretation of ARB No. 51," which addresses consolidation of variable interest entities. FIN 46 expanded the criteria for consideration in determining whether a variable interest entity should be consolidated by a business entity, and requires existing unconsolidated variable interest entities (which include, but are not limited to, Special Purpose Entities, or SPEs) to be consolidated by their primary beneficiaries if the entities do not effectively disperse risks among parties involved. This interpretation applied immediately to variable interest entities created after January 31, 2003, and to variable interest entities in which an enterprise obtains an interest after that date. It applies in the first fiscal year or interim period beginning after June 15, 2003, to variable interest entities in which an enterprise holds a variable interest that it acquired before February 1, 2003. The adoption of FIN 46 is not expected to have a material effect on the Company's results of operations, cash flows or financial position.

Subsequent Events

On April 29, 2003, Johnson & Johnson announced that it had completed its acquisition of Scios Inc., a biopharmaceutical company with a marketed product for cardiovascular disease and research projects focused on auto-immune diseases. The Company acquired Scios in a cash for stock exchange and was valued at approximately $2.4 billion, net of cash. The purchase price allocation is still in process and is not yet available. The Company expects to incur a pre-tax charge for In-Process Research & Development in the second quarter of 2003 in the range of between $700 and $800 million.

Scios is a biopharmaceutical company developing novel treatments for cardiovascular and inflammatory disease. The company's disease-based technology platform integrates expertise in protein biology with computational and medicinal chemistry to identify novel targets and rationally design small molecule compounds for large markets with unmet medical needs. Scios' product NATRECOR(r) is the first novel agent approved for congestive heart failure (CHF) in more than a decade. NATRECOR(r) is a recombinant form of a naturally occurring protein secreted by the heart as part of the body's response to CHF. The drug has several significant advantages over existing therapies for CHF, the single most common cause of hospitalization in the United States for patients over 65. The principal focus of Scios' research and development program is small molecule inhibitors, and includes several potential new treatments for pain and inflammatory diseases, including an advanced p-38 kinase inhibitor program.

On May 6, 2003, the Company announced a definitive agreement to acquire Link Spine Group, Inc., a privately owned corporation that will provide the Company with exclusive worldwide rights to the SB Charite Artificial Disc for the treatment of spine disorders. Under the terms of the agreement, the Company will pay a $325 million upfront payment with further contingent payments due upon achievement of regulatory and other milestones. The transaction is expected to close in the second quarter of 2003 and the Company anticipates an IPR&D charge of approximately $175 million to be incurred in connection with this acquisition.

CAUTIONARY FACTORS THAT MAY AFFECT FUTURE RESULTS

This Form 10-Q contains "forward-looking statements." Forward-looking statements do not relate strictly to historical or current facts and anticipate results based on management's plans that are subject to uncertainty. Forward-looking statements may be identified by the use of words like "plans," "expects," "will," "anticipates," "estimates" and other words of similar meaning in conjunction with, among other things, discussions of future operations, financial performance, the Company's strategy for growth, product development, regulatory approvals, market position and expenditures.

Forward-looking statements are based on current expectations of future events. The Company cannot guarantee that any forward-looking statement will be accurate, although the Company believes that it has been reasonable in its expectations and assumptions. Investors should realize that if underlying assumptions prove inaccurate or unknown risks or uncertainties materialize, actual results could vary materially from the Company's expectations and projections. Investors are therefore cautioned not to place undue reliance on any forward-looking statements. Furthermore, the Company assumes no obligation to update any forward-looking statements as a result of new information or future events or developments.

The Company's Annual Report on Form 10-K for the fiscal year ended December 29, 2002 contains, in Exhibit 99(b), a discussion of various factors that could cause actual results to differ from expectations. That Exhibit from the Form 10-K is incorporated in this filing by reference. The Company notes these factors as permitted by the Private Securities Litigation Reform Act of 1995.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There has been no material change in the Company's assessment of its sensitivity to market risk since its presentation set forth in Item 7A, "Quantitative and Qualitative Disclosures About Market Risk," in its Annual Report on Form 10-K for the fiscal year ended December 29, 2002.

Item 4 - CONTROLS AND PROCEDURES EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

Disclosure controls and procedures. Within 90 days before filing this report, the Company evaluated the effectiveness of the design and operation of its disclosure controls and procedures. The Company's disclosure controls and procedures are the controls and other procedures that the Company has designed to ensure that it records, processes, summarizes and reports in a timely manner the information the Company must disclose in its reports filed under the Securities Exchange Act. William C. Weldon, Chairman and Chief Executive Officer, and Robert J. Darretta, Executive Vice President and Chief Financial Officer, reviewed and participated in this evaluation.

Based on this evaluation, Messrs. Weldon and Darretta concluded that, as of the date of their evaluation, the Company's disclosure controls and procedures were effective.

Internal controls. Since the date of the evaluation described above, there have not been any significant changes in the Company's internal controls or in other factors that could significantly affect those controls, including any corrective actions with regard to significant deficiencies and material weaknesses.

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Part II - OTHER INFORMATION

Item 1. Legal Proceedings

The Company is involved in numerous product liability cases in the United States, many of which concern adverse reactions to drugs and medical devices. The damages claimed are substantial, and while the Company is confident of the adequacy of the warnings and instructions for use which accompany such products, it is not feasible to predict the ultimate outcome of litigation. However, the Company believes that if any liability results from such cases, it will be substantially covered by reserves established under its self-insurance program and by commercially available excess liability insurance.

One group of cases against the Company concerns the Janssen Pharmaceutica, Inc. product PROPULSIDr, which was withdrawn from general sale and restricted to limited use in 2000. In the wake of publicity about those events, numerous lawsuits have been filed against Janssen, which is a wholly owned subsidiary of the Company, and the Company regarding PROPULSIDr, in state and federal courts across the country. There are approximately 740 such cases currently pending, including the claims of approximately 5,428 plaintiffs. In the active cases, 425 individuals are alleged to have died from the use of PROPULSIDr. These actions seek substantial compensatory and punitive damages and accuse Janssen and the Company of inadequately testing for and warning about the drug's side effects, of promoting it for off-label use and of overpromotion. In addition, Janssen and the Company have entered into agreements with various plaintiffs' counsel halting the running of the statutes of limitations with respect to the potential claims of a significant number of individuals while those attorneys evaluate whether or not to sue Janssen and the Company on their behalf.

In September 2001, the first ten plaintiffs in the Rankin case, which comprises the claims of 155 PROPULSIDr plaintiffs, went to trial in state court in Claiborne County, Mississippi. The jury returned compensatory damage verdicts for each plaintiff in the amount of $10 million, for a total of $100 million. The trial judge thereafter dismissed the claims of punitive damages. On March 4, 2002, the trial judge reduced these verdicts to a total of $48 million, and denied the motions of Janssen and the Company for a new trial. Janssen and the Company believe these verdicts, even as reduced, are insupportable and have appealed. In the view of Janssen and the Company, the proof at trial demonstrated that none of these plaintiffs was injured by PROPULSIDr and that no basis for liability existed.

In April 2002, a state court judge in New Jersey denied plaintiffs' motion to certify a national class of PROPULSIDr users for purposes of medical monitoring and refund of the costs of purchasing PROPULSIDr. An effort to appeal that ruling has been denied. In June 2002 the federal judge presiding over the PROPULSIDr Multi-District Litigation in New Orleans, Louisiana similarly denied plaintiffs' motion there to certify a national class of PROPULSIDr users. Plaintiffs in the Multi-District Litigation have said they are preserving their right to appeal that ruling and other complaints filed against Janssen and the Company include class action allegations which could be the basis for future attempts to have classes certified.

With respect to all the various PROPULSIDr actions against them, Janssen and the Company dispute the claims in those lawsuits and are vigorously defending against them except where, in their judgment, settlement is appropriate. Janssen and the Company believe they have adequate self-insurance reserves and commercially available excess insurance with respect to these cases. In communications to the Company, the excess insurance carriers have raised certain defenses to their liability under the policies. However, in the opinion of the Company, those defenses are pro forma and lack substance and the carriers will honor their obligations under the policies either voluntarily or after litigation.

The Company's Ortho Biotech Inc. subsidiary was party to an arbitration proceeding filed against it in 1995 by Amgen, Ortho Biotech's licensor of U.S. non-dialysis rights to PROCRITr, in which Amgen sought to terminate Ortho Biotech's U.S. license rights and collect substantial damages based on alleged deliberate PROCRITr sales by Ortho Biotech during the early 1990s into Amgen's reserved dialysis market. On October 18, 2002, the arbitrator issued his decision rejecting Amgen's request to terminate the license and finding no material breach of the license. However, the arbitrator found that conduct by Ortho Biotech in the early 1990s, which was subsequently halted by Ortho Biotech, amounted to a non-material breach of the license and awarded Amgen $150 million in damages which the Company expensed in the third quarter of 2002. Amgen had sought $1.2 billion in damages. On January 24, 2003, the arbitrator ruled that Amgen was the "prevailing party" in this arbitration, entitling it to an award of reasonable attorneys' fees and costs. In March, Amgen submitted its application for fees and costs in the amount of $91 million, which sum is subject to challenge by Ortho Biotech based on the issue of reasonableness. The Company expensed $85 million in the fourth quarter of 2002 in connection with this outstanding claim.

In patent infringement actions tried in Delaware federal court in late 2000, Cordis Corporation, a subsidiary of Johnson & Johnson, obtained verdicts of infringement and patent validity, and damage awards, against Boston Scientific Corporation and Medtronic AVE, Inc., based on a number of Cordis coronary stent patents. On December 15, 2000, the jury in the damage action against Boston Scientific returned a verdict of $324 million and on December 21, 2000 the jury in the Medtronic AVE action returned a verdict of $271 million. These sums represent lost profit and reasonable royalty damages to compensate Cordis for infringement but do not include pre or post judgment interest. In February 2001 a hearing was held on the claims of Boston Scientific and Medtronic AVE that the patents at issue were unenforceable owing to alleged inequitable conduct before the patent office. In March and May 2002, the district judge issued post trial rulings which confirmed the validity and enforceability of the main Cordis stent patent claims but found certain other Cordis patents unenforceable. Further, the district judge granted Boston Scientific a new trial on liability and damages and vacated the verdict against Medtronic AVE on legal grounds. Appeals to the Federal Circuit Court of Appeals are underway.

The products of various Johnson & Johnson operating companies are the subject of various patent lawsuits which could potentially affect the ability of those operating companies to sell those products, require the payment of past damages and future royalties or, with respect to patent challenges by generic pharmaceutical firms, result in the introduction of generic versions of the products in question and the ensuing loss of market share. The following patent lawsuits concern important products of Johnson & Johnson operating companies. Medtronic AVE v. Cordis Corporation: This action, filed in April 2002 in federal district court in Texas and thereafter transferred to the federal district court in Delaware, asserts certain patents owned by Medtronic AVE against the Cordis BX VELOCITYT stent, which is also the stent structure used in the CYPHERT drug eluting product. No trial date has been set for this action. ACS/Guidant v. Cordis Corporation: This is an arbitration in which ACS/Guidant has asserted its Lau patents against the Cordis BX VELOCITY stent. In the event ACS/Guidant prevails, Cordis would pay a pre-negotiated royalty with respect to past and future BX VELOCITY sales; no injunction would be issued. The arbitration hearings commence in the fall. Boston Scientific Corporation (BSC) v. Cordis Corporation: This action, filed in Delaware federal court in March, asserts that the Cypher drug-eluting stent infringes the Ding patent assigned to BSC. BSC seeks damages and a permanent injunction and in addition has moved for a preliminary injunction, a hearing on which is scheduled for late July.

The following lawsuits are against generic firms that filed Abbreviated New Drug Applications (ANDAs) seeking to market generic forms of products sold by various subsidiaries of the Company prior to expiration of the applicable patents covering these products. These ANDAs typically include allegations of non-infringement, invalidity and unenforceability of these patents. Ortho-McNeil Pharmaceutical, Inc. v. Barr Laboratories, Inc.: Pending in federal court in New Jersey, this action, filed in June 2000, involves Barr's effort to invalidate Ortho's patents covering its ORTHO TRICYCLEN r oral contraceptive product. Trial is scheduled to begin in July. Ortho-McNeil and Daiichi, Inc. v. Mylan Laboratories and Ortho-McNeil and Daiichi, Inc. v. Teva Pharmaceutical: These matters, the first of which was filed in February 2002 in federal court in West Virginia and the second in June 2002 in federal court in New Jersey, concern the efforts of Mylan and Teva to invalidate and establish non-infringement of the patent covering LEVAQUINr levofloxacin tablets. The patent is owned by Daiichi and exclusively licensed to Ortho-McNeil. In the Mylan case trial has been set for October 2003. No trial date has been set in the Teva matter. Ortho-McNeil Pharmaceutical, Inc. and Daiichi v. Bedford Laboratories: This matter was filed in federal district court in New Jersey in April 2003 and involves the effort of Bedford to invalidate and assert non-infringement of the same Daiichi patent on LEVAQUIN involved in the above proceedings. In this case, however, Bedford is challenging the patent's application with respect to its products which it asserts are equivalent to LEVAQUIN injection pre-mix and injection vials, rather than tablets. Janssen and ALZA v. Mylan Laboratories: This action, filed in federal district court in Vermont in January 2002, concerns Mylan's effort to invalidate and assert non-infringement and unenforceability of ALZA's patent covering the DURAGESICr product. Trial is scheduled for August 2003. Janssen Pharmaceutica NV v. Eon Labs Manufacturing: This action was filed in federal court in the Eastern District of New York in April 2001 and concerns Eon's effort to invalidate and establish non-infringement of Janssen's patent covering SPORANOXr (itraconozole). No trial date has yet been scheduled. Ortho-McNeil Pharmaceutical, Inc. v. Kali Laboratories, Inc.: This lawsuit was filed in federal court in New Jersey in November 2002 and concerns the attempt of Kali to invalidate and establish non-infringement of Ortho-McNeil's patent covering ULTRACETr (tramadol-acetaminophen) tablets. No trial date has been set for this case. Alza v. Mylan Laboratories: This action was filed in federal district court in West Virginia in May 2003 and concerns Mylan's effort to invalidate and assert non-infringement of an Alza patent covering the DITROPAN XLr product. No trial date has been set for this case.

With respect to all of the above matters, the Johnson & Johnson operating company involved is vigorously defending the validity and asserting the infringement of its own or its licensors' patents or, where its product is accused of infringing patents held by others, defending against those claims.

The New York State Attorney General's office and the Federal Trade Commission issued subpoenas in January and February 2003 seeking documents relating to the marketing of sutures and endoscopic instruments by the Company's Ethicon, Inc. and Ethicon Endo-Surgery, Inc. subsidiaries. The Connecticut Attorney General's office has requested the same documents. These subpoenas focus on the bundling of sutures and endoscopic instruments in contracts offered to Group Purchasing Organizations and individual hospitals in which discounts are predicated on the hospital achieving specified market share targets for both categories of products. The operating companies involved are responding to the subpoenas.

The Company is also involved in a number of other patent, trademark and other lawsuits incidental to its business.

The ultimate legal and financial liability of the Company in respect to all claims, lawsuits and proceedings referred to above cannot be estimated with any certainty. However, in the opinion of management, based on its examination of these matters, its experience to date and discussions with counsel, the ultimate outcome of these legal proceedings, net of liabilities already accrued in the Company's consolidated balance sheet, is not expected to have a material adverse effect on the Company's consolidated financial position, although the resolution in any reporting period of one or more of these matters could have a significant impact on the Company's results of operations for that period.

Item 5. Exhibits and Reports on Form 8-K

(a) Exhibit

Exhibit 99.3 Certifications Pursuant to Rule 13a-14 Under the Securities Exchange Act of 1934

Exhibit 99.15 Certifications Pursuant to 18 U.S.C. Section 1350

(b) Reports on Form 8-K

A report on Form 8-K was filed on January 30, 2003, which included the Press Release on Amgen arbitration fees and expenses. Also included in this filing are the unaudited comparative supplementary sales data and condensed consolidated statements of earnings for the fiscal fourth quarter and fiscal year ended December 29, 2002.

A report on Form 8-K was filed on March 12, 2003, which included the audited consolidated financial statements for the three year period ended December 29, 2002.

A report on Form 8-K was filed on April 15, 2003, which included the Press Release for the period ended March 30, 2003. Also included in this filing are the unaudited comparative supplementary sales data and condensed consolidated statement of earnings for the fiscal first quarter.

A report on Form 8-K was filed on April 29, 2003, which included a reconciliation of non-GAAP disclosures included in Form 10-K for the fiscal year ended December 29, 2002.

SIGNATURES

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

JOHNSON & JOHNSON
(Registrant)

Date: May 15, 2003	By /s/ R. J. DARRETTA R. J. DARRETTA Executive Vice President and Chief Financial Officer
Date: May 15, 2003	By /s/ S. J. COSGROVE S. J. COSGROVE Controller (Chief Accounting Officer)

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Allowance at end of period	$ 58,733	$ 81,256	$ 58,733	$ 81,256

During the three and six months ended June 30, 2018, we determined that the fair value of the underlying collateral (land development project) securing six loans with a carrying value of $120.9 million was less than the net carrying value of the loans, which resulted in a provision for loan losses of $1.3 million and $1.7 million, respectively.

During the three and six months ended June 30, 2018, we settled, for $31.6 million, a non-performing preferred equity investment in a hotel property with a net carrying value of $29.1 million, resulting in a reserve recovery of $2.5 million and a charge-off of $3.2 million. In addition, we received a payment and recorded a recovery of $0.9 million related to a written-off junior participation interest in an office building.

During the three and six months ended June 30, 2017, a fully reserved multifamily mezzanine loan with a UPB of $1.8 million paid off in full, resulting in a $1.8 million reserve recovery. In addition, during the first quarter of 2017, we recorded a reserve recovery of $0.7 million on a multifamily bridge loan.

The ratio of net recoveries to the average loans and investments outstanding were de minimus for all periods presented.

There were no loans for which the fair value of the collateral securing the loan was less than the carrying value of the loan for which we had not recorded a provision for loan loss as of June 30, 2018 and 2017.

We have six loans with a carrying value totaling $120.9 million at June 30, 2018, which mature in September 2018, that are collateralized by a land development project. The loans do not carry a current pay rate of interest, but five of the loans with a carrying value totaling $111.5 million entitle us to a weighted average accrual rate of interest of 8.89%. In 2008, we suspended the recording of the accrual rate of interest on these loans, as they were impaired and we deemed the collection of this interest to be doubtful. At June 30, 2018 and December 31, 2017, we had cumulative allowances for loan losses of $50.7 million and $49.1 million, respectively, related to these loans. The loans are subject to certain risks associated with a development project including, but not limited to, availability of construction financing, increases in projected construction costs, demand for the development s outputs upon completion of the project, and litigation risk. Additionally, these loans were not classified as non-performing as the borrower is in compliance with all of the terms and conditions of the loans.

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ARBOR REALTY TRUST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

June 30, 2018

A summary of our impaired loans by asset class is as follows (in thousands):

	June 30, 2018			Three Months Ended June 30, 2018		Six Months Ended June 30, 2018	
Asset Class	**UPB**	**Carrying Value (1)**	**Allowance for Loan Losses**	**Average Recorded Investment (2)**	**Interest Income Recognized**	**Average Recorded Investment (2)**	**Interest Income Recognized**
Land	$ 132,559	$ 125,693	$ 55,533	$ 131,985	$	$ 131,823	$
Hotel				17,375		17,375	
Office	2,279	2,279	1,500	2,281	31	2,284	60
Commercial	1,700	1,700	1,700	1,700		1,700	
Total	$ 136,538	$ 129,672	$ 58,733	$ 153,341	$ 31	$ 153,181	$ 60

	December 31, 2017			Three Months Ended June 30, 2017		Six Months Ended June 30, 2017	
Land	$ 131,086	$ 124,812	$ 53,883	$ 131,086	$	$ 131,086	$
Hotel	34,750	34,750	5,700	34,750	60	34,750	371
Office	2,288	2,288	1,500	27,556	27	27,558	51
Commercial	1,700	1,700	1,700	1,700		1,700	
Multifamily				880		1,271	22
Total	$ 169,824	$ 163,550	$ 62,783	$ 195,972	$ 87	$ 196,365	$ 444

(1) Represents the UPB of four impaired loans (less unearned revenue and other holdbacks and adjustments) by asset class at both June 30, 2018 and December 31, 2017.

(2) Represents an average of the beginning and ending UPB of each asset class.

At June 30, 2018, two loans with an aggregate net carrying value of $0.8 million, net of related loan loss reserves of $1.7 million, were classified as non-performing. At December 31, 2017, two loans with an aggregate net carrying value of $29.1 million, net of related loan loss reserves of $7.4 million, were classified as non-performing. Income from non-performing loans is generally recognized on a cash basis when it is received. Full income recognition will resume when the loan becomes contractually current and performance has recommenced.

A summary of our non-performing loans by asset class is as follows (in thousands):

	June 30, 2018			December 31, 2017		
Asset Class	**Carrying Value**	**Less Than 90 Days Past Due**	**Greater Than 90 Days Past Due**	**Carrying Value**	**Less Than 90 Days Past Due**	**Greater Than 90 Days Past Due**

Commercial	$ 1,700	$	$ 1,700	$ 1,700	$	$ 1,700
Hotel				34,750		34,750
Office	831		831			
Total	$ 2,531	$	$ 2,531	$ 36,450	$	$ 36,450

At both June 30, 2018 and December 31, 2017, there were no loans contractually past due 90 days or more that were still accruing interest.

There were no loan modifications, refinancings and/or extensions during the six months ended June 30, 2018 that were considered troubled debt restructurings. During the six months ended June 30, 2017, there was a $34.8 million loan to a hotel property that was modified and considered a troubled debt restructuring as a result of a forbearance agreement entered into with the borrower in the second quarter of 2017. This loan was subsequently classified as non-performing. This loan was modified to increase the total recovery of the combined principal and interest. There were no other loans in which we considered the modifications to be troubled debt restructurings and no additional loans considered to be impaired as a result of our troubled debt restructuring analysis performed during the six months ended June 30, 2018 and 2017.

Given the transitional nature of some of our real estate loans, we may require funds to be placed into an interest reserve, based on contractual requirements, to cover debt service costs. At June 30, 2018, we had total interest reserves of $47.6 million on 92 loans with an aggregate UPB of $1.89 billion. At December 31, 2017, we had total interest reserves of $52.5 million on 81 loans with an aggregate UPB of $1.57 billion.

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ARBOR REALTY TRUST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

June 30, 2018

Note 4 Loans Held-for-Sale, Net

Loans held-for-sale, net consists of the following (in thousands):

	June 30, 2018	December 31, 2017
Fannie Mae	$ 204,658	$ 243,717
Freddie Mac	102,357	47,545
FHA	1,119	987
	308,134	292,249
Fair value of future MSR	4,754	5,806
Unearned discount	(1,401)	(612)
Loans held-for-sale, net	$ 311,487	$ 297,443

Our loans held-for-sale, net are typically sold within 60 days of loan origination and the gain on sales are included in gain on sales, including fee-based services, net in the consolidated statements of income. During the three and six months ended June 30, 2018, we sold $1.02 billion and $2.08 billion, respectively, of loans held-for-sale and recorded gain on sales of $14.8 million and $32.2 million, respectively. During the three and six months ended June 30, 2017, we sold $1.20 billion and $2.57 billion, respectively, of loans held-for-sale and recorded gains on sales of $17.6 million and $35.7 million, respectively. At June 30, 2018 and December 31, 2017, there were no loans held-for-sale that were 90 days or more past due, and there were no loans held-for-sale that were placed on a non-accrual status.

Note 5 Capitalized Mortgage Servicing Rights

Our capitalized mortgage servicing rights (MSRs) reflect commercial real estate MSRs derived from loans sold in our Agency Business. The discount rates used to determine the present value of our MSRs throughout the periods presented for all MSRs were between 8% - 15% (representing a weighted average discount rate of 12%) based on our best estimate of market discount rates. The weighted average estimated life remaining of our MSRs was 7.3 years and 7.2 years at June 30, 2018 and December 31, 2017, respectively.

A summary of our capitalized MSR activity is as follows (in thousands):

	Three Months Ended June 30, 2018						Six Months Ended June 30, 2018					
	Acquired		Originated		Total		Acquired		Originated		Total	
Balance at beginning of period	$	131,934	$	123,798	$	255,732	$	143,270	$	109,338	$	252,608
Additions				18,493		18,493				38,293		38,293
Amortization		(7,517)		(4,420)		(11,937)		(15,512)		(8,290)		(23,802)
Write-downs and payoffs		(4,400)		(867)		(5,267)		(7,741)		(2,337)		(10,078)
Balance at end of period	$	120,017	$	137,004	$	257,021	$	120,017	$	137,004	$	257,021

	Three Months Ended June 30, 2017						Six Months Ended June 30, 2017					
Balance at beginning of period	$	180,945	$	57,986	$	238,931	$	194,801	$	32,942	$	227,743
Additions				19,083		19,083				45,553		45,553
Amortization		(9,660)		(2,168)		(11,828)		(20,122)		(3,594)		(23,716)
Write-downs and payoffs		(3,096)		(7)		(3,103)		(6,490)		(7)		(6,497)
Balance at end of period	$	168,189	$	74,894	$	243,083	$	168,189	$	74,894	$	243,083

We collected prepayment fees of $4.9 million and $8.7 million during the three and six months ended June 30, 2018, respectively, which are included as a component of servicing revenue, net on the consolidated statements of income. During the three and six months ended June 30, 2017, we collected prepayment fees totaling $2.1 million and $4.1 million, respectively. As of June 30, 2018 and December 31, 2017, we had no valuation allowance recorded on any of our MSRs.

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The expected amortization of capitalized MSRs recorded as of June 30, 2018 is shown in the table below. Actual amortization may vary from these estimates (in thousands).

Year		Amortization
2018 (six months ending 12/31/2018)	$	23,934
2019		45,327
2020		40,340
2021		33,259
2022		26,708
2023		22,303
Thereafter		65,150
Total	$	257,021

Note 6 Mortgage Servicing

Product and geographic concentrations that impact our servicing revenue are as follows ($ in thousands):

June 30, 2018					
Product Concentrations				Geographic Concentrations	
Product		UPB	Percent of Total	State	UPB Percentage of Total
Fannie Mae	$	12,794,277	75%	Texas	21%
Freddie Mac		3,730,980	22%	North Carolina	10%
FHA		585,017	3%	California	8%
Total	$	17,110,274	100%	New York	8%
				Georgia	6%
				Florida	6%
				Other (1)	41%
				Total	100%

December 31, 2017					
Product Concentrations				Geographic Concentrations	
Product		UPB	Percent of Total	State	UPB Percentage of Total
Fannie Mae	$	12,502,699	77%	Texas	22%
Freddie Mac		3,166,134	20%	North Carolina	10%
FHA		537,482	3%	California	8%

Total	$	16,206,315	100%	New York	8%
				Georgia	6%
				Florida	6%
				Other (1)	40%
				Total	100%

(1) No other individual state represented 4% or more of the total.

At June 30, 2018 and December 31, 2017, our weighted average servicing fee was 46.9 basis points and 47.7 basis points, respectively. We held cash in escrow for these loans totaling $482.8 million and $477.9 million at June 30, 2018 and December 31, 2017, respectively, which is not reflected in our consolidated balance sheets. These escrows are maintained in separate accounts at several federally insured depository institutions, which may exceed FDIC insured limits. We earn interest income on these escrow deposits, generally based on a market rate of interest negotiated with the financial institutions that hold the escrow deposits. Interest earned on escrows, net of interest paid to the borrower, was $2.7 million and $4.9 million during the three and six months ended June 30, 2018, respectively, and $1.1 million and $1.8 million during the three and six months ended June 30, 2017, respectively, and is a component of servicing revenue, net in the consolidated statements of income.

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Note 7 Securities Held-to-Maturity

Freddie Mac may choose to hold, sell or securitize loans we sell to them under the Freddie Mac SBL program. As part of the securitizations under the SBL program, we have the option to purchase the bottom tranche bond, generally referred to as the B Piece, that represents the bottom 10%, or highest risk, of the securitization. During the six months ended June 30, 2018, we purchased two B Piece bonds with an initial face value of $31.2 million, at a discount, for $21.6 million. As of June 30, 2018, we retained 49%, or $72.2 million initial face value, of five B Piece bonds, which were purchased at a discount for $48.8 million, and sold the remaining 51% to a third party at par. These held-to-maturity securities are carried at cost, net of unamortized discounts, and are collateralized by a pool of multifamily mortgage loans, bear interest at an initial weighted average variable rate of 3.63% and have an estimated weighted average maturity of 5.7 years. The weighted average effective interest rate was 11.42% and 12.97% at June 30, 2018 and December 31, 2017, respectively, including the accretion of discount. Approximately $10.8 million is estimated to mature within one year, $31.0 million is estimated to mature after one year through five years, $20.4 million is estimated to mature after five years through ten years and $9.2 million is estimated to mature after ten years.

The following is a summary of the held-to-maturity securities we held (in thousands):

	Face Value	Carrying Value	Unrealized (Loss) Gain	Estimated Fair Value
June 30, 2018				
B Piece bonds	$ 71,222	$ 50,342	$ (189)	$ 50,153
December 31, 2017				
B Piece bonds	$ 40,566	$ 27,837	$ 602	$ 28,439

As of June 30, 2018, no impairment was recorded on these held-to-maturity securities. During the three and six months ended June 30, 2018, we recorded interest income of $0.5 million and $1.1 million, respectively, and, during the three and six months ended June 30, 2017, we recorded interest income of $0.3 million and $0.4 million, respectively, related to these investments.

Note 8 Investments in Equity Affiliates

We account for all investments in equity affiliates under the equity method. The following is a summary of our investments in equity affiliates (in thousands):

Equity Affiliates	Investments in Equity Affiliates at June 30, 2018	Investments in Equity Affiliates at December 31, 2017	UPB of Loans to Equity Affiliates at June 30, 2018
Arbor Residential Investor LLC	$ 19,631	$ 19,193	$
West Shore Café	2,193	2,140	1,688
Lightstone Value Plus REIT L.P	1,895	1,895	
JT Prime	425	425	
East River Portfolio			
Lexford Portfolio			280,500
Total	$ 24,144	$ 23,653	$ 282,188

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Arbor Residential Investor LLC (ARI). During the three and six months ended June 30, 2018, we recorded income of $0.7 million and $0.8 million, respectively, and, during both the three and six months ended June 30, 2017, we recorded a loss of $0.7 million to income (loss) from equity affiliates in our consolidated statements of income related to our investment in this residential mortgage banking business. In addition, during the first quarter of 2018, we made a $2.4 million payment for our proportionate share of a litigation settlement related to this investment, which was distributed back to us by our equity affiliate.

During both the six months ended June 30, 2018 and 2017, we received cash distributions totaling $0.4 million (which were classified as returns of capital) in connection with a joint venture that invests in non-qualified residential mortgages purchased from ARI s origination platform. During all periods presented, we recorded income of less than $0.1 million to income (loss) from equity affiliates in our consolidated statements of income related to this investment.

Lexford Portfolio. During the three and six months ended June 30, 2018, we received distributions of $0.6 million and $1.2 million, respectively, and, during the three and six months ended June 30, 2017, we received distributions of $0.6 million and $1.3 million, respectively, from this equity investment, which was recognized as income. See Note 18 Agreements and Transactions with Related Parties for details.

Note 9 Real Estate Owned

Our real estate assets at both June 30, 2018 and December 31, 2017 were comprised of a hotel property and an office building.

Real Estate Owned

	June 30, 2018			December 31, 2017		
(in thousands)	**Hotel Property**	**Office Building**	**Total**	**Hotel Property**	**Office Building**	**Total**
Land	$ 3,294	$ 4,509	$ 7,803	$ 3,294	$ 4,509	$ 7,803
Building and intangible assets	30,918	2,010	32,928	30,699	2,010	32,709
Less: Impairment loss	(13,307)	(2,500)	(15,807)	(13,307)	(500)	(13,807)
	(9,505)	(769)	(10,274)	(9,228)	(690)	(9,918)

Less: Accumulated depreciation and amortization												
Real estate owned, net	$	11,400	$	3,250	$	14,650	$	11,458	$	5,329	$	16,787

For the six months ended June 30, 2018 and 2017, our hotel property had a weighted average occupancy rate of 58% and 57%, respectively, a weighted average daily rate of $116 and $117, respectively, and weighted average revenue per available room of $67 for both periods. The operation of a hotel property is seasonal with the majority of revenues earned in the first two quarters of the calendar year. Of the total impairment losses recorded on our hotel property of $13.3 million, $1.5 million and $2.7 million were recorded during the three and six months ended June 30, 2017, respectively.

Our office building was fully occupied by a single tenant until April 2017 when the lease expired. The building is currently vacant. During the three months ended June 30, 2018, based on discussions with market participants, we determined that the office building exhibited indicators of impairment and performed an impairment analysis. As a result of this impairment analysis, we recorded an impairment loss of $2.0 million.

Our real estate owned assets had restricted cash balances totaling $0.8 million and $0.7 million at June 30, 2018 and December 31, 2017, respectively, due to escrow requirements.

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Note 10 Debt Obligations

Credit Facilities and Repurchase Agreements

The following table outlines borrowings under our credit facilities and repurchase agreements ($ in thousands):

				June 30, 2018			December 31, 2017		
	Current Maturity	Extended Maturity	Note Rate	Debt Carrying Value (1)	Collateral Carrying Value	Wtd. Avg. Note Rate	Debt Carrying Value (1)	Collateral Carrying Value	Wtd. Avg. Note Rate
Structured Business									
$375 million repurchase facility	Mar. 2020	Mar. 2021	L + 1.75% to 3.50%	$ 258,712	$ 354,500	4.39%	$ 102,350	$ 145,850	3.90%
$100 million repurchase facility	June 2019	June 2020	L + 1.75% to 2.00%	79,764	111,317	3.92%	2,445	6,600	3.61%
$75 million credit facility	Dec. 2018	N/A	L + 1.75% to 2.50%	24,901	36,799	3.89%			
$75 million credit facility	June 2019	N/A	L + 2.00%	2,894	4,700	4.15%	8,999	16,000	3.61%
$50 million credit facility	Feb. 2019	N/A	L + 2.00%	28,555	35,700	4.15%	32,538	40,700	3.61%
$50 million credit facility	Sept. 2019	Sept. 2021	L + 2.50% to 3.25%				3,581	4,625	4.88%
$25.5 million credit facility	Oct. 2019	N/A	L + 2.50%	15,742	34,000	4.65%	13,920	18,753	4.12%
$25 million working capital facility	June 2019	N/A	L + 2.25%	25,000		4.40%	10,000		4.12%
$23.2 million credit facility	Feb. 2020	Feb. 2021	L + 2.30%	23,085	30,900	4.45%			
$20 million credit facility	Mar. 2020	Mar. 2021	L + 2.50%	19,900	41,650	4.65%			

$17.4 million credit facility	June 2020	June 2021	L + 2.40%	12,374	15,844	4.55%			
$7.5 million credit facility	Aug. 2018	N/A	L + 2.75%	7,461	9,340	4.91%	7,432	9,340	4.37%
Repurchase facility - securities (2)	N/A	N/A	L + 2.50% to 3.50%	101,327		4.80%	53,938		4.45%
$3 million master security agreement	Oct. 2020	N/A	2.96% to 3.42%	1,504		3.20%	1,834		3.21%
$2.2 million master security agreement	Mar. 2021	N/A	4.60%	1,629		4.66%			
Structured Business total				$ 602,848	$ 674,750	4.30%	$ 237,037	$ 241,868	4.02%
Agency Business									
$500 million ASAP agreement (3)	N/A	N/A	L + 1.05%	$ 47,593	$ 47,593	3.14%	$ 121,880	$ 121,880	2.61%
$150 million credit facility	Jan. 2019	N/A	L + 1.30%	126,965	127,100	3.39%	21,802	21,821	2.96%
$150 million credit facility	Aug. 2018	N/A	L + 1.30%	111,669	111,678	3.39%	99,242	99,357	2.91%
$100 million credit facility (4)	June 2019	N/A	L + 1.25%	9,190	9,190	3.39%	23,785	23,785	2.86%
$100 million repurchase facility	Aug. 2018	N/A	L + 1.35%	12,239	12,250	3.44%	24,827	24,873	2.91%
Agency Business total				$ 307,656	$ 307,811	3.35%	$ 291,536	$ 291,716	2.78%
Consolidated total				$ 910,504	$ 982,561	3.98%	$ 528,573	$ 533,584	3.34%

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(1) The debt carrying value for the Structured Business at June 30, 2018 and December 31, 2017 was net of unamortized deferred finance costs of $3.1 million and $2.2 million, respectively. The debt carrying value for the Agency Business at both June 30, 2018 and December 31, 2017 was net of unamortized deferred finance costs of $0.2 million.

(2) As of June 30, 2018 and December 31, 2017, this facility was collateralized by CLO bonds retained by us with a principal balance of $114.2 million and $61.0 million, respectively, and B Piece bonds with a carrying value of $50.3 million and $27.8 million, respectively.

(3) The note rate under this agreement is subject to a LIBOR Floor of 35 basis points.

(4) The committed amount under the facility was temporarily increased to $250.0 million, which expired in January 2018.

Structured Business

At June 30, 2018 and December 31, 2017, the weighted average interest rate for the credit facilities and repurchase agreements of our Structured Business, including certain fees and costs, such as structuring, commitment, non-use and warehousing fees, was 4.72% and 4.51%, respectively. The leverage on our loans and investment portfolio financed through our credit facilities and repurchase agreements, excluding the securities repurchase facility, working capital line of credit and the security agreements used to finance leasehold and capital expenditure improvements at our corporate office, was 71% and 72% at June 30, 2018 and December 31, 2017, respectively.

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In June 2018, we entered into a $17.4 million credit facility to finance a multifamily bridge loan. The facility bears interest at a rate of 240 basis points over LIBOR and matures in June 2020, with a one-year extension option.

In June 2018, we amended our $10.0 million working capital facility to increase the committed amount by $15.0 million to $25.0 million, reduce the interest rate by 25 basis points and extend the maturity date to June 2019.

In April 2018, we amended our $100.0 million repurchase facility adjusting the interest rate from 200 basis points over LIBOR to an interest rate range of 175 basis points to 200 basis points over LIBOR, depending on the class of loan financed.

In April 2018, we amended our $75.0 million credit facility adjusting the interest rate from 200 basis points to 250 basis points over LIBOR to an interest rate range of 175 basis points to 250 basis points over LIBOR, depending on the type of loan financed.

In March 2018, we amended our $225.0 million repurchase facility to increase the committed amount by $75.0 million to $300.0 million, reduce the interest rates by 50 basis points and extend the maturity date to March 2020 with a one-year extension option. In June 2018, we also temporarily increased the committed amount by $75.0 million to $375.0 million, which expires in December 2018.

In March 2018, we entered into a $20.0 million credit facility to finance a healthcare facility bridge loan. The facility bears interest at a rate of 250 basis points over LIBOR and matures in March 2020, with a one-year extension option.

In March 2018, we entered into a master security agreement that was used to finance certain capital expenditures. We have a $2.2 million note payable under this agreement which bears interest at a fixed rate of 4.60%, requires monthly amortization payments and matures in 2021.

In February 2018, we entered into a $23.2 million credit facility to finance a self storage bridge loan. The facility bears interest at a rate of 230 basis points over LIBOR and matures in February 2020, with a one-year extension option.

Agency Business

In April 2018, we amended our $150.0 million credit facility reducing the interest rate 5 basis points to 130 basis points over LIBOR. In July 2018, we temporarily extended the maturity date to August 2018 and are currently in negotiations to amend the agreement and extend its maturity.

In January 2018, we amended our $150.0 million warehouse facility reducing the interest rate 10 basis points to 130 basis points over LIBOR and extending the maturity date one year to January 2019.

Collateralized Loan Obligations (CLOs)

We account for our CLO transactions on our consolidated balance sheet as financing facilities. Our CLOs are VIEs for which we are the primary beneficiary and are consolidated in our financial statements. The investment grade tranches are treated as secured financings, and are non-recourse to us.

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The following table outlines borrowings and the corresponding collateral under our CLOs ($ in thousands):

	Debt			Collateral (3)		
				Loans		Cash
June 30, 2018	**Face Value**	**Carrying Value (1)**	**Wtd. Avg. Rate (2)**	**UPB**	**Carrying Value**	**Restricted Cash (4)**
CLO X	$ 441,000	$ 435,885	3.59%	$ 502,781	$ 500,646	$ 49,554
CLO IX	356,400	351,625	3.50%	460,925	459,562	75
CLO VIII	282,874	279,221	3.45%	330,112	329,213	26,288
CLO VII	279,000	275,919	4.14%	318,684	317,773	36,134
CLO VI	250,250	247,994	4.63%	297,133	296,065	25,491
Total CLOs	$ 1,609,524	$ 1,590,644	3.80%	$ 1,909,635	$ 1,903,259	$ 137,542
December 31, 2017						
CLO IX	$ 356,400	$ 351,042	2.97%	$ 372,350	$ 371,236	$ 88,650
CLO VIII	282,874	278,606	2.92%	364,838	363,339	162
CLO VII	279,000	275,331	3.61%	346,524	345,220	13,476
CLO VI	250,250	247,470	4.10%	314,382	313,582	10,618
CLO V	267,750	265,973	4.06%	347,797	346,803	2,203
Total CLOs	$ 1,436,274	$ 1,418,422	3.48%	$ 1,745,891	$ 1,740,180	$ 115,109

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(1) Debt carrying value is net of $18.9 million and $17.9 million of deferred financing fees at June 30, 2018 and December 31, 2017, respectively.

(2) At June 30, 2018 and December 31, 2017, the aggregate weighted average note rate for our CLOs, including certain fees and costs, was 4.34% and 4.08%, respectively.

(3) As of June 30, 2018 and December 31, 2017, there was no collateral at risk of default or deemed to be a credit risk as defined by the CLO indenture.

(4) Represents restricted cash held for principal repayments as well as for reinvestment in the CLOs. Does not include restricted cash related to interest payments, delayed fundings and expenses.

CLO X In June 2018, we completed a collateralized securitization vehicle (CLO X), issuing seven tranches of CLO notes through two newly-formed wholly-owned subsidiaries totaling $494.2 million. Of the total CLO notes issued, $441.0 million were investment grade notes issued to third party investors and $53.2 million were below investment grade notes retained by us. As of the CLO closing date, the notes were secured by a portfolio of loan obligations with a face value of $501.9 million, consisting primarily of bridge loans that were contributed from our existing loan portfolio. The financing has a four-year replacement period that allows the principal proceeds and sale proceeds (if any) of the loan obligations to be reinvested in qualifying replacement loan obligations, subject to the satisfaction of certain conditions set forth in the indenture. Thereafter, the outstanding debt balance will be reduced as loans are repaid. Initially, the proceeds of the issuance of the securities also included $58.1 million for the purpose of acquiring additional loan obligations for a period of up to 120 days from the CLO closing date. Subsequently, the issuer will own loan obligations with a face value of $560.0 million, representing leverage of 79%. We retained a residual interest in the portfolio with a notional amount of $119.0 million, including the $53.2 million below investment grade notes. The notes had an initial weighted average interest rate of 1.45% plus one-month LIBOR and interest payments on the notes are payable monthly.

CLO V In June 2018, we completed the unwind of CLO V, redeeming $267.8 million of outstanding notes which were repaid primarily from the refinancing of the remaining assets within our existing financing facilities (including CLO X), as well as with cash held by CLO V, and expensed $1.3 million of deferred financing fees into interest expense on the consolidated statements of income.

Luxembourg Debt Fund

In November 2017, we formed a $100.0 million Luxembourg commercial real estate debt fund (Debt Fund) and issued $70.0 million of floating rate notes to third party investors which bear an initial interest rate of 4.15% over LIBOR. The notes mature in 2025 and we retained a $30.0 million equity interest in the Debt Fund. The Debt Fund is a VIE for which we are the primary beneficiary and is consolidated in our financial statements. The Debt Fund is secured by a portfolio of loan obligations with a face value of $100.0 million, which includes first mortgage bridge loans, senior participation interests in first mortgage bridge loans, subordinate participation interest in first mortgage bridge loans and participation interests in mezzanine loans. The Debt Fund allows, for a period of three years, principal proceeds from portfolio assets to be reinvested in qualifying replacement assets, subject to certain conditions.

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Borrowings and the corresponding collateral under our Debt Fund are as follows ($ in thousands):

Debt			Collateral (3)		
			Loans		Cash Restricted Cash (4)
Face Value	Carrying Value (1)	Wtd. Avg. Rate (2)	UPB	Carrying Value	
June 30, 2018					
$ 70,000	$ 68,270	6.33%	$ 97,700	$ 97,323	$
December 31, 2017					
$ 70,000	$ 68,084	5.79%	$ 96,995	$ 96,564	$ 3,005

(1) Debt carrying value is net of $1.7 million and $1.9 million of deferred financing fees at June 30, 2018 and December 31, 2017, respectively.

(2) At June 30, 2018 and December 31, 2017, the aggregate weighted average note rate, including certain fees and costs, was 6.84% and 6.05%, respectively.

(3) At both June 30, 2018 and December 31, 2017, there was no collateral at risk of default or deemed to be a credit risk.

(4) Represents restricted cash held for reinvestment. Excludes restricted cash related to interest payments, delayed fundings and expenses.

Senior Unsecured Notes

In March 2018, we issued $100.0 million aggregate principal amount of 5.625% senior unsecured notes due in May 2023 (the Initial Notes) in a private placement, and, in May 2018, we issued an additional $25.0 million (the Reopened Notes and, together with the Initial Notes, the 5.625% Notes,) which brought the aggregate outstanding principal amount to $125.0 million. The Reopened Notes are fully fungible with, and rank equally in right of payment with the Initial Notes. We received total proceeds of $122.3 million from the issuances, after deducting the underwriting discount and other offering expenses. We used the net proceeds from the Initial Notes to fully redeem our 7.375% senior unsecured notes due in 2021 (the 7.375% Notes) totaling $97.9 million and the net proceeds from the Reopened Notes to make investments and for general corporate purposes. The 5.625% Notes are unsecured and can be redeemed by us at any time prior to April 1, 2023, at a redemption price equal to 100% of the aggregate principal amount, plus a make-whole premium and accrued and unpaid interest. We have the right to redeem the 5.625% Notes on or after April 1, 2023, at a redemption price equal to 100% of the aggregate principal amount, plus accrued and unpaid interest. The interest is paid semiannually in May and November starting in November 2018. At June 30, 2018, the debt carrying value of the 5.625%

Notes was $122.3 million, net of $2.7 million of deferred financing fees, and the weighted average note rate was 6.08%, including certain fees and costs.

At December 31, 2017, the debt carrying value of our 7.375% Notes was $95.3 million, which was net of $2.6 million of deferred financing fees, and the weighted average note rate was 8.16%.

Convertible Senior Unsecured Notes

In November 2017, we issued $143.8 million aggregate principal amount of 5.375% convertible senior unsecured notes (the 5.375% Convertible Notes). We received total proceeds of $139.2 million from the offering, net of deferred financing fees, which is amortized through interest expense over the life of the 5.375% Convertible Notes. The initial conversion rate was 107.7122 shares of common stock per $1,000 principal amount of 5.375% Convertible Notes and represents a conversion price of $9.28 per share of common stock. At June 30, 2018, the 5.375% Convertible Notes had a conversion rate of 108.6502 shares of common stock per $1,000 principal amount of 5.375% Convertible Notes, which represented a conversion price of $9.20 per share of common stock. The 5.375% Convertible Notes pay interest semiannually in arrears. The 5.375% Convertible Notes have a scheduled maturity in November 2020. See Subsequent Events section below for details of our repurchase of substantially all of the 5.375% Convertible Notes.

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In 2016, we issued $86.3 million aggregate principal amount of 6.50% convertible senior unsecured notes (the 6.50% Convertible Notes) and, in January 2017, we issued an additional $13.8 million of the 6.50% Convertible Notes. We received total proceeds of $95.8 million from the offerings, net of deferred financing fees, which are amortized through interest expense over the life of the 6.50% Convertible Notes. The initial conversion rate was 119.3033 shares of common stock per $1,000 principal amount of 6.50% Convertible Notes and represented a conversion price of $8.38 per share of common stock. At June 30, 2018, the 6.50% Convertible Notes had a conversion rate of 122.3263 shares of common stock per $1,000 principal amount of notes, which represented a conversion price of $8.17 per share of common stock. The 6.50% Convertible Notes pay interest semiannually in arrears. The 6.50% Convertible Notes have a scheduled maturity in October 2019. See Subsequent Events section below for details of our repurchase of substantially all of the 6.50% Convertible Notes.

Our convertible senior unsecured notes are not redeemable by us prior to their maturities and are convertible into, at our election, cash, shares of our common stock or a combination of both, subject to the satisfaction of certain conditions and during specified periods. The conversion rates are subject to adjustment upon the occurrence of certain specified events and the holders may require us to repurchase all or any portion of their notes for cash equal to 100% of the principal amount of the notes, plus accrued and unpaid interest, if we undergo a fundamental change as specified in the agreements.

Accounting guidance requires that convertible debt instruments with cash settlement features, including partial cash settlement, account for the liability component and equity component (conversion feature) of the instrument separately. The initial value of the liability component reflects the present value of the discounted cash flows using the nonconvertible debt borrowing rate at the time of the issuance. The debt discount represents the difference between the proceeds received from the issuance and the initial carrying value of the liability component, which is accreted back to the notes principal amount through interest expense over the term of the notes, which was 1.92 years and 2.41 years at June 30, 2018 and December 31, 2017, respectively, on a weighted average basis.

The UPB, unamortized discount and net carrying amount of the liability and equity components of the convertible notes were as follows (in thousands):

	Liability Component				Equity Component
Period	**UPB**	**Unamortized Debt Discount**	**Unamortized Deferred Financing Fees**	**Net Carrying Value**	**Net Carrying Value**
June 30, 2018	$ 243,750	$ 4,568	$ 3,751	$ 235,431	$ 6,733
December 31, 2017	$ 243,750	$ 5,742	$ 6,721	$ 231,287	$ 6,733

During the three months ended June 30, 2018, we incurred total interest expense on the notes of $6.1 million, of which $3.2 million, $2.3 million and $0.6 million related to the cash coupon, amortization of the deferred financing fees and of the debt discount, respectively. During the six months ended June 30, 2018, we incurred total interest expense on the notes of $11.0 million, of which $6.8 million, $3.0 million and $1.2 million related to the cash coupon, amortization of the deferred financing fees and of the debt discount, respectively. During the three months ended June 30, 2017, we incurred total interest expense on the notes of $2.2 million, of which $1.6 million, $0.4 million and $0.2 million related to the cash coupon, amortization of the deferred financing fees and of the debt discount, respectively. During the six months ended June 30, 2017, we incurred total interest expense on the notes of $4.3 million, of which $3.2 million, $0.7 million and $0.4 million related to the cash coupon, amortization of the deferred financing fees and of the debt discount, respectively. Including the amortization of the deferred financing fees and debt discount, our weighted average total cost of the notes is 7.96% per annum.

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Subsequent Events

In July 2018, we completed the issuance and sale of $245.0 million in aggregate principal amount of 5.25% convertible senior notes (the 5.25% Convertible Notes) through two private placements, including $15.0 million of the initial purchaser s over-allotment option. The initial purchasers of the 5.25% Convertible Notes have the option to purchase up to an additional $19.5 million of these notes solely to cover over-allotments. The 5.25% Convertible Notes mature in July 2021, unless earlier converted or repurchased by the holders pursuant to their terms, and pay interest semiannually in arrears. We received proceeds totaling $237.2 million, net of the underwriter s discount and fees from these offerings. We used the net proceeds to exchange $99.8 million of our 6.50% Convertible Notes and $127.6 million of our 5.375% Convertible Notes for a combination of $219.8 million in cash (which includes accrued interest) and 6.8 million shares of our common stock to settle such exchanges. The remaining net proceeds were used for general corporate purposes.

Junior Subordinated Notes

In the first quarter of 2017, we purchased, at a discount, $20.9 million of our junior subordinated notes with a carrying value of $19.8 million and recorded a gain on extinguishment of debt of $7.1 million. As a result, we settled our related equity investment and extinguished $21.5 million of notes. The carrying value of borrowings under our junior subordinated notes was $139.9 million and $139.6 million at June 30, 2018 and December 31, 2017, respectively, which is net of a deferred amount of $12.3 million and $12.5 million, respectively, (which is amortized into interest expense over the life of the notes) and deferred financing fees of $2.2 million in both periods. These notes have maturities ranging from March 2034 through April 2037 and pay interest quarterly at a fixed or floating rate of interest based on LIBOR. The current weighted average note rate was 5.18% and 4.53% at June 30, 2018 and December 31, 2017, respectively. Including certain fees and costs, the weighted average note rate was 5.28% and 4.63% at June 30, 2018 and December 31, 2017, respectively.

Related Party Financing

In connection with the Acquisition, we entered into a five year $50.0 million preferred equity interest financing agreement with ACM to finance a portion of the aggregate purchase price. At December 31, 2017, the outstanding principal balance was $50.0 million. In January 2018, we paid $50.0 million in full satisfaction of this debt. During the six months ended June 30, 2018, we recorded interest expense of $0.3 million and, during the three and six months ended June 30, 2017, we recorded interest expense of $1.0 million and $1.9 million, respectively.

Debt Covenants

Credit Facilities and Repurchase Agreements. The credit facilities and repurchase agreements contain various financial covenants, including, but not limited to, minimum liquidity requirements, minimum net worth requirements, as well as certain other debt service coverage ratios, debt to equity ratios and minimum servicing portfolio tests. We were in compliance with all financial covenants and restrictions at June 30, 2018.

CLOs. Our CLO vehicles contain interest coverage and asset overcollateralization covenants that must be met as of the waterfall distribution date in order for us to receive such payments. If we fail these covenants in any of our CLOs, all cash flows from the applicable CLO would be diverted to repay principal and interest on the outstanding CLO bonds and we would not receive any residual payments until that CLO regained compliance with such tests. Our CLOs were in compliance with all such covenants as of June 30, 2018, as well as on the most recent determination dates in July 2018. In the event of a breach of the CLO covenants that could not be cured in the near-term, we would be required to fund our non-CLO expenses, including employee costs, distributions required to maintain our REIT status, debt costs, and other expenses with (i) cash on hand, (ii) income from any CLO not in breach of a covenant test, (iii) income from real property and loan assets, (iv) sale of assets, or (v) accessing the equity or debt capital markets, if available. We have the right to cure covenant breaches which would resume normal residual payments to us by purchasing non-performing loans out of the CLOs. However, we may not have sufficient liquidity available to do so at such time.

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A summary of our CLO compliance tests as of the most recent determination dates in July 2018 is as follows:

Cash Flow Triggers	CLO VI	CLO VII	CLO VIII	CLO IX	CLO X
Overcollateralization (1)					
Current	129.87%	129.03%	129.03%	134.68%	126.98%
Limit	128.87%	128.03%	128.03%	133.68%	125.98%
Pass / Fail	Pass	Pass	Pass	Pass	Pass
Interest Coverage (2)					
Current	191.10%	216.08%	252.91%	255.51%	201.62%
Limit	120.00%	120.00%	120.00%	120.00%	120.00%
Pass / Fail	Pass	Pass	Pass	Pass	Pass

(1) The overcollateralization ratio divides the total principal balance of all collateral in the CLO by the total principal balance of the bonds associated with the applicable ratio. To the extent an asset is considered a defaulted security, the asset s principal balance for purposes of the overcollateralization test is the lesser of the asset s market value or the principal balance of the defaulted asset multiplied by the asset s recovery rate which is determined by the rating agencies. Rating downgrades of CLO collateral will generally not have a direct impact on the principal balance of a CLO asset for purposes of calculating the CLO overcollateralization test unless the rating downgrade is below a significantly low threshold (e.g. CCC-) as defined in each CLO vehicle.

(2) The interest coverage ratio divides interest income by interest expense for the classes senior to those retained by us.

Our CLO overcollateralization ratios as of the determination dates subsequent to each quarter are as follows:

Determination (1)	CLO VI	CLO VII	CLO VIII	CLO IX	CLO X
July 2018	129.87%	129.03%	129.03%	134.68%	126.98%
April 2018	129.87%	129.03%	129.03%	134.69%	
January 2018	129.87%	129.03%	129.03%	134.68%	
October 2017	129.87%	129.03%	129.03%		
July 2017	129.87%	129.03%			

(1) The table above represents the quarterly trend of our overcollateralization ratio, however, the CLO determination dates are monthly and we were in compliance with this test for all periods presented.

The ratio will fluctuate based on the performance of the underlying assets, transfers of assets into the CLOs prior to the expiration of their respective replenishment dates, purchase or disposal of other investments, and loan payoffs. No payment due under the junior subordinated indentures may be paid if there is a default under any senior debt and the senior lender has sent notice to the trustee. The junior subordinated indentures are also cross-defaulted with each other.

Note 11 Allowance for Loss-Sharing Obligations

Our allowance for loss-sharing obligations related to the Fannie Mae DUS program is as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Beginning balance	$ 31,097	$ 32,219	$ 30,511	$ 32,407
Provisions for loss sharing	1,134	1,890	2,339	4,145
Provisions reversal for loan repayments	(785)	(1,358)	(1,518)	(1,933)
Charge-offs, net	(44)	46	70	(1,822)
Ending balance	$ 31,402	$ 32,797	$ 31,402	$ 32,797

When we settle a loss under the DUS loss-sharing model, the net loss is charged-off against the previously recorded loss-sharing obligation. The settled loss is often net of any previously advanced principal and interest payments in accordance with the DUS program, which are reflected as reductions to the proceeds needed to settle losses. At December 31, 2017, we had outstanding advances of $0.1 million, which were netted against the allowance for loss-sharing obligations.

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At June 30, 2018 and December 31, 2017, the maximum quantifiable liability associated with our guarantees under the Fannie Mae DUS agreement was $2.30 billion and $2.24 billion, respectively. The maximum quantifiable liability is not representative of the actual loss we would incur. We would be liable for this amount only if all of the loans we service for Fannie Mae, for which we retain some risk of loss, were to default and all of the collateral underlying these loans was determined to be without value at the time of settlement.

Note 12 Derivative Financial Instruments

The following is a summary of our non-qualifying derivative financial instruments held by our Agency Business ($ in thousands):

			June 30, 2018		
				Fair Value	
Derivative	**Count**	**Notional Value**	**Balance Sheet Location**	**Derivative Assets**	**Derivative Liabilities**
Rate Lock Commitments	10	$ 72,653	Other Assets/ Other Liabilities	$ 606	$ (295)
Forward Sale Commitments	63	380,786	Other Assets/ Other Liabilities	1,515	(61)
		$ 453,439		$ 2,121	$ (356)

			December 31, 2017		
Rate Lock Commitments	3	$ 38,578	Other Assets/ Other Liabilities	$ 276	$ (278)
Forward Sale Commitments	75	330,827	Other Assets/ Other Liabilities	408	(1,028)
		$ 369,405		$ 684	$ (1,306)

We enter into contractual commitments to originate and sell mortgage loans at fixed prices with fixed expiration dates. The commitments become effective when the borrower rate locks a specified interest rate within time frames established by us. All potential borrowers are evaluated for creditworthiness prior to the extension of the commitment. Market risk arises if interest rates move adversely between the time of the rate lock by the borrower and the sale date of the loan to an investor. To mitigate the effect of the interest rate risk inherent in providing rate lock commitments to borrowers, we enter into a forward sale commitment with the investor simultaneous with the rate lock commitment with the borrower. The forward sale contract locks in an interest rate and price for the sale of the loan. The terms of the contract with the investor and the rate lock with the borrower are matched in substantially all respects, with the objective of eliminating interest rate risk to the extent practical. Sale commitments with the investors have an expiration date that is longer than our related commitments to the borrower to allow, among other things, for the closing of the loan and processing of paperwork to deliver the loan into the sale commitment.

These commitments meet the definition of a derivative and are recorded at fair value, including the effects of interest rate movements which are reflected as a component of other income, net in the consolidated statements of income. The estimated fair value of rate lock commitments also includes the fair value of the expected net cash flows associated with the servicing of the loan which is recorded as income from MSRs in the consolidated statements of income. During the three and six months ended June 30, 2018, we recorded a net loss of $0.6 million and a net gain

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of $2.1 million, respectively, from changes in the fair value of these derivatives in other income, net and $17.9 million and $37.6 million, respectively, of income from MSRs. During the three and six months ended June 30, 2017, we recorded $1.6 million and $2.5 million, respectively, of net losses from changes in the fair value of these derivatives in other income, net and $17.3 million and $37.3 million, respectively, of income from MSRs. See Note 13 Fair Value for details.

Note 13 Fair Value

Fair value estimates are dependent upon subjective assumptions and involve significant uncertainties resulting in variability in estimates with changes in assumptions. The following table summarizes the principal amounts, carrying values and the estimated fair values of our financial instruments (in thousands):

	June 30, 2018			December 31, 2017		
	Principal / Notional Amount	Carrying Value	Estimated Fair Value	Principal / Notional Amount	Carrying Value	Estimated Fair Value
Financial assets:						
Loans and investments, net	$ 3,134,879	$ 3,064,798	$ 3,149,044	$ 2,652,538	$ 2,579,127	$ 2,652,520
Loans held-for-sale, net	308,134	311,487	316,815	292,249	297,443	302,883
Capitalized mortgage servicing rights, net	n/a	257,021	302,698	n/a	252,608	286,073
Securities held-to-maturity, net	71,222	50,342	50,153	40,566	27,837	28,439
Derivative financial instuments	372,967	2,121	2,121	77,984	684	684
Financial liabilities:						
Credit and repurchase facilities	$ 913,774	$ 910,504	$ 911,893	$ 530,938	$ 528,573	$ 529,992
Collateralized loan obligations	1,609,524	1,590,644	1,613,801	1,436,274	1,418,422	1,436,871
Debt fund	70,000	68,270	70,133	70,000	68,084	70,000
Senior unsecured notes	125,000	122,343	124,813	97,860	95,280	99,582
Convertible senior unsecured notes, net	243,750	235,431	275,595	243,750	231,287	254,335
Junior subordinated notes	154,336	139,909	95,052	154,336	139,590	94,215
Related party financing				50,000	50,000	49,682
Derivative financial instruments	80,472	356	356	291,421	1,306	1,306

Assets and liabilities disclosed at fair value are categorized based upon the level of judgment associated with the inputs used to measure their fair value. Hierarchical levels directly related to the amount of subjectivity associated with the inputs to fair valuation of these assets and liabilities are as follows:

Level 1 Inputs are unadjusted and quoted prices exist in active markets for identical assets or liabilities, such as government, agency and equity securities.

Level 2 Inputs (other than quoted prices included in Level 1) are observable for the asset or liability through correlation with market data. Level 2 inputs may include quoted market prices for a similar asset or liability, interest rates and credit risk. Examples include non-government securities, certain mortgage and asset-backed securities, certain corporate debt and certain derivative instruments.

Level 3 Inputs reflect our best estimate of what market participants would use in pricing the asset or liability and are based on significant unobservable inputs that require a considerable amount of judgment and assumptions. Examples include certain mortgage and asset-backed securities, certain corporate debt and certain derivative instruments.

Determining which category an asset or liability falls within the hierarchy requires significant judgment and we evaluate our hierarchy disclosures each quarter.

The following is a description of the valuation techniques used to measure fair value and the general classification of these instruments pursuant to the fair value hierarchy.

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Loans and investments, net. Fair values of loans and investments that are not impaired are estimated using Level 3 inputs based on direct capitalization rate and discounted cash flow methodologies using discount rates, which, in our opinion, best reflect current market interest rates that would be offered for loans with similar characteristics and credit quality. Fair values of impaired loans and investments are estimated using Level 3 inputs that require significant judgments, which include assumptions regarding discount rates, capitalization rates, creditworthiness of major tenants, occupancy rates, availability of financing, exit plan and other factors.

Loans held-for-sale, net. Consists of originated loans that are generally transferred or sold within 60 days of loan funding, and are valued using pricing models that incorporate observable inputs from current market assumptions or a hypothetical securitization model utilizing observable market data from recent securitization spreads and observable pricing of loans with similar characteristics (Level 2). Fair value includes the fair value allocated to the associated future MSRs and is calculated pursuant to the valuation techniques described below for capitalized mortgage servicing rights, net (Level 3).

Capitalized mortgage servicing rights, net. Fair values are estimated using Level 3 inputs based on discounted future net cash flow methodology. The fair value of MSRs carried at amortized cost are estimated using a process that involves the use of independent third-party valuation experts, supported by commercially available discounted cash flow models and analysis of current market data. The key inputs used in estimating fair value include the contractually specified servicing fees, prepayment speed of the underlying loans, discount rate, annual per loan cost to service loans, delinquency rates, late charges and other economic factors.

Securities held-to-maturity, net. Fair values are approximated using Level 3 inputs based on current market quotes received from financial sources that trade such securities and are based on prevailing market data and, in some cases, are derived from third party proprietary models based on well recognized financial principles and reasonable estimates about relevant future market conditions.

Derivative financial instruments. The fair values of rate lock and forward sale commitments are estimated using valuation techniques, which include internally-developed models developed based on changes in the U.S. Treasury rate and other observable market data (Level 2). The fair value of rate lock commitments includes the fair value of the expected net cash flows associated with the servicing of the loans, see capitalized mortgage servicing rights, net above for details on the applicable valuation technique (Level 3). We also consider the impact of counterparty non-performance risk when measuring the fair value of these derivatives. Given the credit quality of our counterparties, the short duration of interest rate lock commitments and forward sale contracts, and our historical experience, the risk of nonperformance by our counterparties is not significant.

Credit facilities and repurchase agreements. Fair values for credit facilities and repurchase agreements of the Structured Business are estimated at Level 3 using discounted cash flow methodology, using discount rates, which, in our opinion, best reflect current market interest rates for financing with similar characteristics and credit quality. The majority of our credit facilities and repurchase agreement for the Agency Business bear interest at rates that are similar to those available in the market currently and the fair values are estimated using Level 2 inputs. For these facilities, the fair values approximate their carrying values.

Collateralized loan obligations, Debt Fund, junior subordinated notes and related party financing. Fair values are estimated at Level 3 based on broker quotations, representing the discounted expected future cash flows at a yield that reflects current market interest rates and credit spreads.

Senior unsecured notes. Fair values are estimated at Level 1 when current market quotes received from active markets are available. If quotes from active markets are unavailable, then the fair values are estimated at Level 2 utilizing current market quotes received from inactive markets.

Convertible senior unsecured notes, net. Fair values are estimated at Level 2 based on current market quotes received from inactive markets.

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We measure certain financial assets and financial liabilities at fair value on a recurring basis. The fair values of these financial assets and liabilities were determined using the following input levels as of June 30, 2018 (in thousands):

	Carrying Value	Fair Value	Fair Value Measurements Using Fair Value Hierarchy Level 1	Level 2	Level 3
Financial assets:					
Derivative financial instruments	$ 2,121	$ 2,121	$	$ 1,515	$ 606
Financial liabilities:					
Derivative financial instruments	$ 356	$ 356	$	$ 356	$

We measure certain financial and non-financial assets at fair value on a nonrecurring basis. The fair values of these financial and non-financial assets were determined using the following input levels as of June 30, 2018 (in thousands):

	Net Carrying Value	Fair Value	Fair Value Measurements Using Fair Value Hierarchy Level 1	Level 2	Level 3
Financial assets:					
Impaired loans, net (1)	$ 70,939	$ 70,939	$	$	$ 70,939
Non-financial assets:					
Long-lived assets (2)	$ 14,650	$ 14,650	$	$	$ 14,650

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(1) We had an allowance for loan losses of $58.7 million relating to four loans with an aggregate carrying value, before loan loss reserves, of $129.7 million at June 30, 2018.

(2) We recorded a $2.0 million impairment loss during the three months ended June 30, 2018 on the office building we own. See Note 9 Real Estate Owned for details.

Loan impairment assessments. Loans held for investment are intended to be held to maturity and, accordingly, are carried at cost, net of unamortized loan origination costs and fees, loan purchase discounts, and net of the allowance for loan losses, when such loan or investment is deemed to be impaired. We consider a loan impaired when, based upon current information, it is probable that we will be unable to collect all amounts due for both principal and interest according to the contractual terms of the loan agreement. We evaluate our loans to determine if the value of the underlying collateral securing the impaired loan is less than the net carrying value of the loan, which may result in an allowance and corresponding charge to the provision for loan losses. These valuations require significant judgments, which include assumptions regarding capitalization and discount rates, revenue growth rates, creditworthiness of major tenants, occupancy rates, availability of financing, exit plan and other factors. The table above and below includes all impaired loans, regardless of the period in which the impairment was recognized.

Long-lived assets. We review our real estate owned assets when events or circumstances change, indicating that the carrying amount of an asset may not be partially or fully recoverable. In the evaluation of a real estate owned asset for impairment, many factors are considered, including broker quotes, estimated current and expected operating cash flows from the asset during the projected holding period, costs necessary to extend the life or improve the asset, expected capitalization rates, projected stabilized net operating income, selling costs, and the ability to hold and dispose of the asset in the ordinary course of business. We first compare the undiscounted cash flows to be generated by the asset and broker quotes, if any, to the carrying value of such asset. If the undiscounted cash flows and/or broker quotes are less than the carrying value, we recognize an impairment loss by comparing the carrying value of the asset to its fair value.

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Quantitative information about Level 3 fair value measurements at June 30, 2018 were as follows ($ in thousands):

	Fair Value	Valuation Techniques	Significant Unobservable Inputs	
Financial assets:				
Impaired loans:				
Land	$ 70,160	Discounted cash flows	Discount rate	15.00%
[redacted]				
			Revenue growth rate	3.00%
Office	779	Discounted cash flows	Discount rate	10.53%
[redacted]				
			Revenue growth rate	2.63%
Derivative financial instruments:				
Rate lock commitments	606	Discounted cash flows	W/A discount rate	8.77%
Non-financial assets:				
Long-lived assets:				
Office Building	$ 3,250	Broker quotes	N/A	N/A

The derivative financial instruments using Level 3 inputs are outstanding for short periods of time (generally less than 60 days). A roll-forward of Level 3 derivative instruments were as follows (in thousands):

	Fair Value Measurements Using Significant Unobservable Inputs			
	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Derivative assets and liabilities, net				
Balance at beginning of period	$ 717	$ 381	$ 276	$ 2,816
Settlements	(18,047)	(16,216)	(37,240)	(35,865)
Realized gains recorded in earnings	17,330	15,835	36,964	33,049
Unrealized gains recorded in earnings	606	1,420	606	1,420
Balance at end of period	$ 606	$ 1,420	$ 606	$ 1,420

The components of fair value and other relevant information associated with our rate lock commitments, forward sales commitments and the estimated fair value of cash flows from servicing on loans held-for-sale were as follows (in thousands):

June 30, 2018	Notional/ Principal Amount	Fair Value of Servicing Rights	Interest Rate Movement Effect	Total Fair Value Adjustment
Rate lock commitments	$ 72,653	$ 606	$ (295)	$ 311
Forward sale commitments	380,786		295	295
Loans held-for-sale, net (1)	308,134	4,754		4,754
Total		$ 5,360	$	$ 5,360

(1) Loans held-for-sale, net are recorded at the lower of cost or market on an aggregate basis and includes fair value adjustments related to estimated cash flows from MSRs.

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We measure certain assets and liabilities for which fair value is only disclosed. The fair value of these assets and liabilities was determined using the following input levels as of June 30, 2018 (in thousands):

			Fair Value Measurements Using Fair Value Hierarchy		
	Carrying Value	Fair Value	Level 1	Level 2	Level 3
Financial assets:					
Loans and investments, net	$ 3,064,798	$ 3,149,044	$	$	$ 3,149,044
Loans held-for-sale, net	311,487	316,815		312,061	4,754
Capitalized mortgage servicing rights, net	257,021	302,698			302,698
Securities held-to-maturity, net	50,342	50,153			50,153
Financial liabilities:					
Credit and repurchase facilities	$ 910,504	$ 911,893	$	$ 307,656	$ 604,237
Collateralized loan obligations	1,590,644	1,613,801			1,613,801
Debt fund	68,270	70,133			70,133
Senior unsecured notes	122,343	124,813	124,813		
Convertible senior unsecured notes, net	235,431	275,595		275,595	
Junior subordinated notes	139,909	95,052			95,052

Note 14 Commitments and Contingencies

Debt Obligations. Our debt obligations have maturities of $441.6 million for the remainder of 2018, $572.7 million in 2019, $1.08 billion in 2020, $457.4 million in 2021, $179.4 million in 2022 and $380.7 million thereafter.

Agency Business Commitments. Our Agency Business is subject to supervision by certain regulatory agencies. Among other things, these agencies require us to meet certain minimum net worth, operational liquidity and restricted liquidity collateral requirements, and compliance with reporting requirements. Our adjusted net worth and liquidity required by the agencies for all periods presented exceeded these requirements.

As of June 30, 2018, we were required to maintain at least $12.6 million of liquid assets in one of our subsidiaries to meet our operational liquidity requirements for Fannie Mae and we had operational liquidity in excess of this requirement.

We are generally required to share the risk of any losses associated with loans sold under the Fannie Mae DUS program and are required to secure this obligation by assigning restricted cash balances and/or a letter of credit to Fannie Mae. The amount of collateral required by Fannie Mae is a formulaic calculation at the loan level by a Fannie Mae assigned tier which considers the loan balance, risk level of the loan, age of the loan and level of risk-sharing. Fannie Mae requires restricted liquidity for Tier 2 loans of 75 basis points, 15 basis points for Tier 3 loans and 5 basis points for Tier 4 loans, which is funded over a 48-month period that begins upon delivery of the loan to Fannie Mae. A significant portion of our Fannie Mae DUS serviced loans for which we have risk sharing are Tier 2 loans. As of June 30, 2018, we met the restricted liquidity requirement with a $42.0 million letter of credit and $0.7 million of cash collateral.

As of June 30, 2018, reserve requirements for the Fannie Mae DUS loan portfolio will require us to fund $28.4 million in additional restricted liquidity over the next 48 months, assuming no further principal paydowns, prepayments, or defaults within our at-risk portfolio. Fannie Mae periodically reassesses these collateral requirements and may make changes to these requirements in the future. We generate sufficient cash flow from our operations to meet these capital standards and do not expect any changes to have a material impact on our future operations; however, future changes to collateral requirements may adversely impact our available cash.

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We are subject to various capital requirements in connection with seller/servicer agreements that we have entered into with secondary market investors. Failure to maintain minimum capital requirements could result in our inability to originate and service loans for the respective investor and, therefore, could have a direct material effect on our consolidated financial statements. As of June 30, 2018, we met all of Fannie Mae s quarterly capital requirements and our Fannie Mae adjusted net worth was in excess of the required net worth. We are not subject to capital requirements on a quarterly basis for Ginnie Mae or FHA, as such requirements for these investors are only required on an annual basis.

As an approved designated seller/servicer under Freddie Mac s SBL program, we are required to post collateral to ensure that we are able to meet certain purchase and loss obligations required by this program. Under the SBL program, we are required to post collateral equal to $5.0 million, which is satisfied with a $5.0 million letter of credit.

We enter into contractual commitments with borrowers providing rate lock commitments while simultaneously entering into forward sale commitments with investors. These commitments are outstanding for short periods of time (generally less than 60 days) and are described in Note 12 Derivative Financial Instruments and Note 13 Fair Value.

Unfunded Commitments. In accordance with certain structured loans and investments, we have outstanding unfunded commitments of $73.3 million as of June 30, 2018 that we are obligated to fund as borrowers meet certain requirements. Specific requirements include, but are not limited to, property renovations, building construction and conversions based on criteria met by the borrower in accordance with the loan agreements.

Litigation. We are currently neither subject to any material litigation nor, to the best of our knowledge, threatened by any material litigation other than the following:

In June 2011, three related lawsuits were filed by the Extended Stay Litigation Trust (the Trust), a post-bankruptcy litigation trust alleged to have standing to pursue claims that previously had been held by Extended Stay, Inc. and the Homestead Village L.L.C. family of companies (together ESI) (formerly Chapter 11 debtors, together the Debtors) that have emerged from bankruptcy. Two of the lawsuits were filed in the U.S. Bankruptcy Court for the Southern District of New York, and the third in the Supreme Court of the State of New York, New York County. There were 73 defendants in the three lawsuits, including 55 corporate and partnership entities and 18 individuals. A subsidiary of ours and certain other entities that are affiliates of ours are included as defendants. The New York State Court action has been removed to the Bankruptcy Court. Our affiliates filed a motion to dismiss the three lawsuits.

The lawsuits all allege, as a factual basis and background certain facts surrounding the June 2007 leveraged buyout of ESI from affiliates of Blackstone Capital. Our subsidiary, Arbor ESH II, LLC, had a $115.0 million investment in the Series A1 Preferred Units of a holding company of Extended Stay, Inc. The New York State Court action and one of the two federal court actions name as defendants, Arbor ESH II, LLC, ACM and ABT-ESI LLC, an entity in which we have a membership interest, among the broad group of defendants. These two actions were commenced by substantially identical complaints. The defendants are alleged in these complaints, among other things, to have breached fiduciary and contractual duties by causing or allowing the Debtors to pay illegal dividends or other improper distributions of value at a time when the Debtors were insolvent. These two complaints also allege that the defendants aided and abetted, induced, or participated in breaches of fiduciary duty, waste, and unjust enrichment (Fiduciary Duty Claims) and name a director of ours, and a former general counsel of ACM, each of whom had served on the Board of Directors of ESI for a period of time. We are defending these two defendants and paying the costs of such defense. On the basis of the foregoing allegations, the Trust has asserted claims under a number of common law theories, seeking the return of assets transferred by the Debtors prior to the Debtors bankruptcy filing.

In the third action, filed in Bankruptcy Court, the same plaintiff, the Trust, has named ACM and ABT-ESI LLC, together with a number of other defendants and asserts claims, including constructive and fraudulent conveyance claims under state and federal statutes, as well as a claim under the Federal Debt Collection Procedure Act.

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In June 2013, the Trust filed a motion to amend the lawsuits, to, among other things, (i) consolidate the lawsuits into one lawsuit, (ii) remove 47 defendants, none of whom are related to us, from the lawsuits so that there are 26 remaining defendants, including 16 corporate and partnership entities and 10 individuals, and (iii) reduce the counts within the lawsuits from over 100 down to 17. The remaining counts in the amended complaint against our affiliates are principally state law claims for breach of fiduciary duties, waste, unlawful dividends and unjust enrichment, and claims under the Bankruptcy Code for avoidance and recovery actions, among others. The bankruptcy court granted the motion and the amended complaint has been filed. The amended complaint seeks approximately $139.0 million in the aggregate, plus interest from the date of the alleged unlawful transfers, from director designees, portions of which are also sought from our affiliates as well as from unaffiliated defendants. We have moved to dismiss the referenced actions and intend to vigorously defend against the claims asserted therein. During a status conference held in March 2014, the Court heard oral argument on the motion to dismiss and adjourned the case pending a ruling. Subsequent to that hearing, a new judge was assigned to the case and, in November 2016, the new judge entered an order directing the parties to file supplemental briefs addressing new cases decided since the last round of briefing. Oral arguments regarding the motion to dismiss were heard at a hearing held in January 2017. The Court reserved decision at that hearing.

We have not made a loss accrual for this litigation because we believe that it is not probable that a loss has been incurred and an amount cannot be reasonably estimated.

Due to Borrowers. Due to borrowers represents borrowers funds held by us to fund certain expenditures or to be released at our discretion upon the occurrence of certain pre-specified events, and to serve as additional collateral for borrowers loans. While retained, these balances earn interest in accordance with the specific loan terms they are associated with.

Subsequent Event. In July 2018, we received approximately $11 million from the settlement of a litigation related to a prior investment. We will record a gain of approximately $11 million in the third quarter of 2018 related to this settlement.

Note 15 Variable Interest Entities

Our involvement with VIEs primarily affects our financial performance and cash flows through amounts recorded in interest income, interest expense, provision for loan losses and through activity associated with our derivative instruments.

Consolidated VIEs. We have determined that our operating partnership, ARLP, and our CLO and Debt Fund entities, which we consolidate, are VIEs. ARLP is already consolidated in our financial statements, therefore, the identification of this entity as a VIE had no impact on our consolidated financial statements.

Our CLO and Debt Fund consolidated entities invest in real estate and real estate-related securities and are financed by the issuance of debt securities. We, or one of our affiliates, are named collateral manager, servicer, and special servicer for all collateral assets held in CLOs, which we believe gives us the power to direct the most significant economic activities of those entities. We also have exposure to losses to the extent of our equity interests and also have rights to waterfall payments in excess of required payments to bond investors. As a result of consolidation, equity interests have been eliminated, and the consolidated balance sheets reflect both the assets held and debt issued by the CLOs and Debt Fund to third parties. Our operating results and cash flows include the gross amounts related to CLO and Debt Fund assets and liabilities as opposed to our net economic interests in those entities.

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The assets and liabilities related to these consolidated CLOs and Debt Fund are as follows (in thousands):

	June 30, 2018		December 31, 2017	
Assets:				
Restricted cash	$	172,169	$	138,736
Loans and investments, net		2,000,582		1,836,744
Other assets		15,711		14,011
Total assets	$	2,188,462	$	1,989,491
Liabilities:				
Collateralized loan obligations	$	1,590,644	$	1,418,422
Debt fund		68,270		68,084
Other liabilities		3,408		2,046
Total liabilities	$	1,662,322	$	1,488,552

Assets held by the CLOs and Debt Fund are restricted and can only be used to settle obligations of the CLOs and Debt Fund, respectively. The liabilities of the CLOs and Debt Fund are non-recourse to us and can only be satisfied from each respective asset pool. See Note 10 Debt Obligations for details. We are not obligated to provide, have not provided, and do not intend to provide financial support to any of the consolidated CLOs or Debt Fund.

Unconsolidated VIEs. We determined that we are not the primary beneficiary of 24 VIEs in which we have a variable interest as of June 30, 2018 because we do not have the ability to direct the activities of the VIEs that most significantly impact each entity s economic performance.

The following is a summary of our variable interests in identified VIEs, of which we are not the primary beneficiary, as of June 30, 2018 (in thousands):

Type	Carrying Amount (1)	
Loans	$	345,288
B Piece bonds		50,342
Agency interest only strips		3,617
Equity investments		2,193
Total	$	401,440

(1) Represents the carrying amount of loans and investments before reserves. At June 30, 2018, $128.0 million of loans to VIEs had corresponding loan loss reserves of $57.0 million. See Note 3 Loans and Investments for details. In addition, the maximum loss exposure as of June 30, 2018 would not exceed the carrying amount of our investment.

These unconsolidated VIEs have exposure to real estate debt of approximately $3.09 billion at June 30, 2018.

Note 16 Equity

Preferred Stock. The Series A and B preferred stock became redeemable by us in February 2018 and May 2018, respectively. The Series C preferred stock may not be redeemed by us before February 2019.

Common Stock. In May 2018, we completed a public offering in which we sold 5,500,000 shares of our common stock for $8.72 per share, and received net proceeds of $47.8 million after deducting the underwriter s discount and other offering expenses. The proceeds were used to make investments and for general corporate purposes.

We have an At-The-Market equity offering sales agreement with JMP Securities LLC (JMP,) which entitles us to issue and sell up to 7,500,000 shares of our common stock through JMP. Sales of the shares are made by means of ordinary brokers transactions or otherwise at market prices prevailing at the time of sale, or at negotiated prices.

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During the six months ended June 30, 2018, we sold 952,700 shares for net proceeds of $8.1 million. As of June 30, 2018, we had approximately 6,500,000 shares available under this agreement.

In June 2018, we filed, and the SEC declared effective, a new shelf registration statement for $500.0 million of debt securities, common stock, preferred stock, depositary shares and warrants.

Noncontrolling Interest. Noncontrolling interest relates to the 21,230,769 operating partnership units (OP Units) issued to satisfy a portion of the Acquisition purchase price. The value of these OP Units at the Acquisition date was $154.8 million. Each of these OP Units are paired with one share of our special voting preferred shares having a par value of $0.01 per share and is entitled to one vote each on any matter submitted for stockholder approval, which represents approximately 23.6% of the voting power of our outstanding stock at June 30, 2018. The OP Units are entitled to receive distributions if and when our Board of Directors authorizes and declares common stock distributions. The OP Units are also redeemable for cash, or at our option, for shares of our common stock on a one-for-one basis.

Distributions. Dividends declared (on a per share basis) during the six months ended June 30, 2018 were as follows:

Common Stock			Preferred Stock						
						Dividend (1)			
Declaration Date		Dividend	Declaration Date		Series A		Series B		Series C
February 21, 2018	$	0.21	February 2, 2018	$	0.515625	$	0.484375	$	0.53125
May 2, 2018	$	0.25	May 2, 2018	$	0.515625	$	0.484375	$	0.53125

(1) The dividend declared on May 2, 2018 was for March 1, 2018 through May 31, 2018 and the dividend declared on February 2, 2018 was for December 1, 2017 through February 28, 2018.

Common Stock On August 1, 2018, the Board of Directors declared a cash dividend of $0.25 per share of common stock. The dividend is payable on August 31, 2018 to common stockholders of record as of the close of business on August 15, 2018.

Preferred Stock On August 1, 2018, the Board of Directors declared a cash dividend of $0.515625 per share of 8.25% Series A preferred stock; a cash dividend of $0.484375 per share of 7.75% Series B preferred stock; and a cash dividend of $0.53125 per share of 8.50% Series C preferred stock. These amounts reflect dividends from June 1, 2018 through August 31, 2018 and are payable on August 31, 2018 to preferred stockholders of record on August 15, 2018.

Deferred Compensation. In March 2018, we issued 265,444 shares of restricted common stock under the 2017 Amended Omnibus Stock Incentive Plan (the 2017 Plan) to certain employees of ours with a total grant date fair value of $2.3 million and recorded $0.8 million to employee compensation and benefits in our consolidated statements of income. One third of the shares vested as of the grant date, one third will vest in March 2019, and the remaining third will vest in March 2020. In March 2018, we also issued 58,620 shares of fully vested common stock to the independent members of the Board of Directors under the 2017 Plan and recorded $0.5 million to selling and administrative expense in our consolidated statements of income.

During the first quarter of 2018, we issued 63,584 shares of restricted common stock to our chief executive officer under his 2017 annual incentive agreement with a grant date fair value of $0.6 million and recorded $0.1 million to employee compensation and benefits in our consolidated statements of income. One quarter of the shares vested as of the grant date and one quarter will vest on each of the first, second and third anniversaries of the grant date. Our chief executive officer was also granted up to 381,503 performance-based restricted stock units that vest at the end of a four-year performance period based on our achievement of certain total stockholder return objectives. The restricted stock units had a grant date fair value of $0.8 million and we recorded less than $0.1 million to employee compensation and benefits in our consolidated statements of income.

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Earnings Per Share (EPS). Basic EPS is calculated by dividing net income attributable to common stockholders by the weighted average number of shares of common stock outstanding during each period inclusive of unvested restricted stock with full dividend participation rights. Diluted EPS is calculated by dividing net income by the weighted average number of shares of common stock outstanding plus the additional dilutive effect of common stock equivalents during each period using the treasury stock method. Our common stock equivalents include the weighted average dilutive effect of performance-based restricted stock units granted to our chief executive officer, OP Units and convertible senior unsecured notes.

The following tables reconcile the numerator and denominator of our basic and diluted EPS computations ($ in thousands, except share and per share data):

	Three Months Ended June 30,			
	2018		2017	
	Basic	Diluted	Basic	Diluted
Net income attributable to common stockholders (1)	$ 17,167	$ 17,167	$ 11,929	$ 11,929
Net income attributable to noncontrolling interest (2)		5,557		4,494
Net income attributable to common stockholders and noncontrolling interest	$ 17,167	$ 22,724	$ 11,929	$ 16,423
Weighted average shares outstanding	65,683,057	65,683,057	56,652,334	56,652,334
Dilutive effect of OP Units (2)		21,230,769		21,230,769
Dilutive effect of restricted stock units (3)		1,499,921		1,088,108
Dilutive effect of convertible notes (4)		1,641,423		93,292
Weighted average shares outstanding	65,683,057	90,055,170	56,652,334	79,064,503
Net income per common share (1)	$ 0.26	$ 0.25	$ 0.21	$ 0.21

	Six Months Ended June 30,			
	2018		2017	
	Basic	Diluted	Basic	Diluted
Net income attributable to common stockholders (1)	$ 43,356	$ 43,356	$ 27,543	$ 27,543
Net income attributable to noncontrolling interest (2)		14,547		10,935
Net income attributable to common stockholders and noncontrolling interest	$ 43,356	$ 57,903	$ 27,543	$ 38,478

Weighted average shares outstanding	63,773,306	63,773,306	54,071,085	54,071,085
Dilutive effect of OP Units (2)		21,230,769		21,230,769
Dilutive effect of restricted stock units (3)		1,381,310		1,063,264
Dilutive effect of convertible notes (4)		1,035,158		
Weighted average shares outstanding	63,773,306	87,420,543	54,071,085	76,365,118
Net income per common share (1)	$ 0.68	$ 0.66	$ 0.51	$ 0.50

(1) Net of preferred stock dividends.

(2) We consider OP Units to be common stock equivalents as the holders have voting rights, the right to distributions and the right to redeem the OP Units for the cash value of a corresponding number of shares of common stock or a corresponding number of shares of common stock, at our election.

(3) Mr. Kaufman is granted restricted stock units annually, which vest at the end of a four-year performance period based upon our achievement of total stockholder return objectives.

(4) The convertible senior unsecured notes impact diluted earnings per share if the average price of our common stock exceeds the conversion price, as calculated in accordance with the terms of the indenture.

Note 17 Income Taxes

As a REIT, we are generally not subject to U.S. federal income tax to the extent of our distributions to stockholders and as long as certain asset, income, distribution, ownership and administrative tests are met. To maintain our qualification as a REIT, we must annually distribute at least 90% of our REIT-taxable income to our stockholders

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and meet certain other requirements. We may also be subject to certain state, local and franchise taxes. Under certain circumstances, federal income and excise taxes may be due on our undistributed taxable income. If we were to fail to meet these requirements, we would be subject to U.S. federal income tax, which could have a material adverse impact on our results of operations and amounts available for distributions to our stockholders. We believe that all of the criteria to maintain our REIT qualification have been met for the applicable periods, but there can be no assurance that these criteria will continue to be met in subsequent periods.

The Agency Business is operated through our TRS Consolidated Group and is subject to U.S. federal, state and local income taxes. In general, our TRS entities may hold assets that the REIT cannot hold directly and may engage in real estate or non-real estate-related business.

The Tax Reform was signed into law on December 22, 2017. Among numerous provisions included in the new tax law was the reduction of the corporate federal income tax rate from 35% to 21%. Our provision for income taxes in the six months ended June 30, 2018 reflects the newly enacted corporate federal income tax rate of 21%. The final impact of the Tax Reform may differ due to, and among other things, changes in interpretations, assumptions made by us, the issuance of additional guidance and actions we may take as a result of the Tax Reform.

In the three and six months ended June 30, 2018, we recorded a tax provision of $4.5 million and a tax benefit of $4.3 million, respectively. In the three and six months ended June 30, 2017, we recorded a tax provision of $3.4 million and $9.5 million, respectively. The provision for income taxes recorded in the three months ended June 30, 2018 consisted of a current tax provision of $4.3 million and a deferred tax provision of $0.2 million. The benefit from income taxes recorded in the six months ended June 30, 2018 consisted of a current tax provision of $8.8 million and a deferred tax benefit of $13.1 million. The deferred tax benefit recorded in the six months ended June 30, 2018 was due primarily to our payoff in January 2018 of the $50.0 million preferred equity interest entered into with ACM to finance a portion of the Acquisition purchase price. See Note 10 Debt Obligations for details. The provision for income taxes recorded in the three months ended June 30, 2017 consisted of a current tax provision of $4.3 million and a deferred tax benefit of $0.9 million. The provision for income taxes recorded in the six months ended June 30, 2017 consisted of a current tax provision of $8.6 million and a deferred tax provision of $0.9 million.

Current and deferred taxes are primarily recorded on the portion of earnings (losses) recognized by us with respect to our interest in the TRS s. Deferred income tax assets and liabilities are calculated based on temporary differences between our U.S. GAAP consolidated financial statements and the federal, state, local tax basis of assets and liabilities as of the consolidated balance sheets.

Note 18 Agreements and Transactions with Related Parties

Management Agreement. Prior to May 31, 2017, we had a management agreement with ACM, pursuant to which ACM provided us with a variety of professional and advisory services vital to our operations, including underwriting, accounting and treasury, compliance, marketing, information technology and human resources. Pursuant to the terms of the management agreement, we reimbursed ACM for its actual costs incurred in connection with managing our business through a base management fee, and, under certain circumstances, an annual incentive fee. In May 2017, we terminated the existing management agreement. We incurred base management fees of $2.7 million and $6.7 million in the three and six months ended June 30, 2017, respectively.

We have a shared services agreement with ACM where we provide limited support services to ACM and they reimburse us for the costs of performing such services. During the three and six months ended June 30, 2018, we incurred $0.3 million and $0.6 million, respectively, and, during both the three and six months ended June 30, 2017, we incurred $0.1 million of costs for services provided to ACM, which are included in due from related party on the consolidated balance sheets.

Other Related Party Transactions. Due from related party was $10.2 million and $0.7 million at June 30, 2018 and December 31, 2017, respectively. The increase was primarily due to payoffs to be remitted by our affiliated servicing operations related to real estate transactions.

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Due to related party was $0.3 million at June 30, 2018 and consisted of loan payoffs, holdbacks and escrows to be remitted to our affiliated servicing operations related to real estate transactions.

In June 2018, we originated a $21.7 million bridge loan on a multifamily property owned in part by a consortium of investors (which includes, among other unaffiliated investors, certain of our officers and our chief executive officer) which owns 75% in the borrowing entity. The loan has an interest rate of LIBOR plus 4.75%, with a LIBOR floor of 1.25%, and matures in June 2021. Interest income recorded from this loan totaled $0.1 million for both the three and six months ended June 30, 2018.

In April 2018, we acquired a $9.4 million bridge loan which was originated by ACM. The loan was used to purchase several multifamily properties by a consortium of investors (which includes, among other unaffiliated investors, certain of our officers and our chief executive officer) which owns 75% of the borrowing entity. The loan has an interest rate of LIBOR plus 5.0% with a LIBOR floor of 1.25% and matures in January 2021. Interest income recorded from this loan totaled $0.1 million for both the three and six months ended June 30, 2018.

In January 2018, we paid $50.0 million in full satisfaction of the related party financing we entered into with ACM to finance a portion of the Acquisition purchase price. We incurred interest expense related to this financing of $0.3 million for the six months ended June 30, 2018 and $1.0 million and $1.9 million for the three and six months ended June 30, 2017, respectively.

In December 2017, we acquired a $32.8 million bridge loan which was originated by ACM. The loan was used to purchase several multifamily properties by a consortium of investors (which includes, among other unaffiliated investors, certain of our officers and our chief executive officer) which owns 90% of the borrowing entity. The loan has an interest rate of LIBOR plus 5.0%, with a LIBOR floor of 1.13%, and matures in June 2020. Interest income recorded from this loan totaled $0.6 million and $1.1 million for the three and six months ended June 30, 2018.

In the fourth quarter of 2017, we originated two bridge loans totaling $28.0 million on two multifamily properties owned in part by a consortium of investors (which includes, among other unaffiliated investors, certain of our officers and our chief executive officer) which owns 45% in the borrowing entity. The loans have an interest rate of LIBOR plus 5.25% with LIBOR floors ranging from 1.24% to 1.54% and mature in the fourth quarter of 2020. Interest income recorded from these loans totaled $0.5 million and $1.0 million for the three and six months ended June 30, 2018.

In July 2017, we originated a $36.0 million bridge loan on a multifamily property owned in part by a consortium of investors. The consortium of investors (which includes, among other unaffiliated investors, certain of our officers and our chief executive officer) owns an interest of 95% in the borrowing entity. The loan has an interest rate of LIBOR plus 4.5% with a LIBOR floor of 1% and matures in July 2020. Interest income recorded from this loan totaled $0.6 million and $1.2 million for the three and six months ended June 30, 2018.

In May 2017, we originated a $46.9 million Fannie Mae loan on a multifamily property owned in part by a consortium of investors (which includes, among other unaffiliated investors, certain of our officers) which owns a 21.4% interest in the borrowing entity. We carry a maximum loss-sharing obligation with Fannie Mae on this loan of up to 5% of the original UPB. Servicing revenue recorded from this loan was less than $0.1 million for all periods presented.

In March 2017, a consortium of investors (which includes, among other unaffiliated investors, our chief executive officer and ACM) invested $2.0 million for a 26.1% ownership interest in two portfolios of multifamily properties which has two bridge loans totaling $14.8 million originated by us in 2016. The loans have an interest rate of LIBOR plus 5.25% with a LIBOR floor of 0.5% and mature in November 2018. One of the loans was repaid in full in the fourth quarter of 2017 and the remaining loan paid off in June 2018. Interest income recorded from these loans totaled $0.2 million and $0.3 million for the three and six months ended June 30, 2018, respectively, and $0.3 million and $0.5 million for the three and six months ended June 30, 2017, respectively.

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In January 2017, we modified a $5.0 million preferred equity investment, subsequently increasing our balance to $15.0 million, with a commitment to fund an additional $5.0 million. This investment had a fixed interest rate of 11% that was scheduled to mature in January 2020, however, the principal was repaid in full in the fourth quarter of 2017. We also entered into an agreement with a consortium of investors (which includes, among other unaffiliated investors, certain of our officers and our chief executive officer) which admitted them as a member to fund the remaining $5.0 million preferred equity investment, which was generally subordinate to our investment. Interest income recorded from our investment totaled $0.2 million and $0.3 million in the three and six months ended June 30, 2017.

In January 2017, Ginkgo Investment Company LLC (Ginkgo), of which one of our directors is a 33% managing member, purchased a multifamily apartment complex which assumed an existing $8.3 million Fannie Mae loan that we service. Ginkgo subsequently sold the majority of its interest in this property and owned a 3.6% interest at June 30, 2018. We carry a maximum loss-sharing obligation with Fannie Mae on this loan of up to 20% of the original UPB. Upon the sale, we received a 1% loan assumption fee which was governed by existing loan agreements that were in place when the loan was originated in 2015, prior to such purchase. Servicing revenue recorded from this loan was less than $0.1 million for all periods presented.

In 2016, we originated $48.0 million of bridge loans on six multifamily properties owned in part by a consortium of investors (which includes, among other unaffiliated investors, certain of our officers and our chief executive officer) which owns interests ranging from 10.5% to 12.0% in the borrowing entities. The loans have an interest rate of LIBOR plus 4.5% with a LIBOR floor of 0.25% and mature in September 2019. In August 2017, a $6.8 million loan on one of the properties paid off in full and in May 2018 three additional loans totaling $23.2 million paid off in full. Interest income recorded from these loans totaled $0.6 million and $1.3 million for the three and six months ended June 30, 2018, respectively, and $0.7 million and $1.3 million for the three and six months ended June 30, 2017, respectively.

In 2016, we originated a $12.7 million bridge loan and a $5.2 million preferred equity investment on two multifamily properties owned in part by a consortium of investors (which includes, among other unaffiliated investors, certain of our officers and our chief executive officer) which owns an interest of 50% in the borrowing entity. The loan has an interest rate of LIBOR plus 4.5% with a LIBOR floor of 0.25% and matures in January 2019. The preferred equity investment has a fixed interest rate of 10% and a maturity date extended to November 2018. Interest income recorded from these loans totaled $0.3 million and $0.7 million for the three and six months ended June 30, 2018, respectively, and $0.3 million and $0.6 million for the three and six months ended June 30, 2017, respectively.

In 2016, we originated a $19.0 million bridge loan on a multifamily property owned in part by a consortium of investors (which includes, among other unaffiliated investors, certain of our officers and our chief executive officer) which owns an interest of 7.5% in the borrowing entity. The loan had an interest rate of LIBOR plus 4.5% with a LIBOR floor of 0.25% and was scheduled to mature in January 2019. In January 2018, this loan paid off in full. Interest income recorded from this loan totaled $0.3 million for the six months ended June 30, 2018 and $0.3 million and $0.6 million for the three and six months ended June 30, 2017, respectively.

In 2015, we originated a $7.1 million bridge loan on a multifamily property owned in part by a consortium of investors (which includes, among other unaffiliated investors, certain of our officers and our chief executive officer) which owns an interest of 7.5% in the borrowing entity. In August 2017, this loan paid off in full. The loan had an interest rate of LIBOR plus 4.5%, with a LIBOR floor of 0.25%. Interest income recorded from this loan totaled $0.1 million and $0.2 million for the three and six months ended June 30, 2017, respectively.

In 2015, we originated two bridge loans totaling $16.7 million secured by multifamily properties acquired by a third party investor. The properties were owned and were sold in part by a consortium of investors (which includes, among other unaffiliated investors, certain of our officers, our chief executive officer and certain other related parties). The loans have an interest rate of LIBOR plus 5% with a LIBOR floor of 0.25% and were extended as of right to October 2018. Interest income recorded from these loans totaled $0.3 million and $0.7 million for the three and six months ended June 30, 2018, respectively, and $0.3 million and $0.5 million for the three and six months ended June 30, 2017, respectively.

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In 2015, we originated a $3.0 million mezzanine loan on a multifamily property that has a $47.0 million first mortgage initially originated by ACM. The loan bore interest at a fixed rate of 12.5% and was scheduled to mature in April 2025. In January 2018, this loan paid off in full. Interest income recorded from this loan totaled $0.1 million for the six months ended June 30, 2018 and $0.1 million and $0.2 million for the three and six months ended June 30, 2017, respectively.

In 2015, we invested $9.6 million for 50% of ACM s indirect interest in a joint venture with a third party that was formed to invest in a residential mortgage banking business. As a result of this transaction, we had an initial indirect interest of 22.5% in this entity. Since the initial investment, we invested an additional $16.1 million through this joint venture in non-qualified residential mortgages purchased from the mortgage banking business s origination platform and we received cash distributions totaling $16.6 million (that were classified as returns of capital) as a result of the joint venture selling most of its mortgage assets (which $0.4 million was received in the six months ended June 30, 2018). We recorded income from these investments of $0.7 million and $0.8 million in the three and six months ended June 30, 2018, respectively, and a loss of $0.7 million and $0.6 million in the three and six months ended June 30, 2017, respectively. In connection with a litigation settlement related to this investment, we provided a guaranty of up to 50% of any amounts payable in connection with the settlement. ACM has also provided us with a guaranty to pay up to 50% of any amounts we may pay under this guaranty. As of June 30, 2018, our maximum exposure under this guaranty totals $2.7 million. We have not accrued this amount as we do not believe that we will be required to make any nonrefundable payments under this guaranty. See Note 8 Investments in Equity Affiliates for details.

In 2014, we invested $0.1 million for a 5% interest in a joint venture that owns two multifamily properties. The joint venture is comprised of a consortium of investors (which includes, among other unaffiliated investors, certain of our officers, our chief executive officer and certain other related parties) which owns an interest of 95%. We had a $1.7 million bridge loan to the joint venture with an interest rate of 5.5% over LIBOR. The loan was repaid in full in the fourth quarter of 2017. Interest income recorded from this loan was less than $0.1 million and $0.1 million for the three and six months ended June 30, 2017, respectively.

In 2014, we originated a $30.4 million bridge loan for an office property owned in part by a consortium of investors (which includes, among other unaffiliated investors, our chief executive officer and his affiliates) which owns an interest of 24% in the borrowing entity. The loan matured in August 2017 and was refinanced with a $43.2 million bridge loan that has an interest rate of 4% over LIBOR with a LIBOR floor of 1.23% and an August 2020 maturity date. We also originated a $4.6 million mezzanine loan in 2016 to this entity that had a fixed interest rate of 12%, which was repaid in full at maturity in August 2017. In the fourth quarter of 2017, the consortium of investors sold their ownership interest in the borrowing entity. Interest income recorded from these loans totaled $0.8 million and $1.6 million for the three and six months ended June 30, 2017, respectively.

In 2014, ACM purchased a property subject to two loans originated by us, a first mortgage of $14.6 million and a second mortgage of $5.1 million, both with maturity dates of April 2016 and an interest rate of 4.8% over LIBOR. In 2016, the $5.1 million second mortgage was repaid in full and the $14.6 million first mortgage was extended to April 2018 and paid off at maturity. Interest income recorded from these loans totaled less than $0.1 million and $0.2 million for the three and six months ended June 30, 2018, respectively, and $0.2 million and $0.4 million for the three and six months ended June 30, 2017, respectively.

We, along with an executive officer of ours and a consortium of independent outside investors, hold equity investments in a portfolio of multifamily properties referred to as the Lexford Portfolio (Lexford), which is managed by an entity owned primarily by a consortium of affiliated investors, including our chief executive officer and an executive officer of ours. Based on the terms of the management contract, the management company is entitled to 4.75% of gross revenues of the underlying properties, along with the potential to share in the proceeds of a sale or restructuring of the debt. In June 2018, the owners of Lexford restructured part of its debt and we originated twelve bridge loans totaling $280.5 million, which were used to repay in full certain existing mortgage debt and to

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renovate 72 multifamily properties included in the portfolio. The loans which we originated in June 2018 have interest rates of 400 basis points over LIBOR and mature in June 2021 (with 2 one-year extension options). Interest income recorded from these loans totaled $1.1 million in June 2018. Further, as part of this June 2018 restructuring, $50.0 million in unsecured financing was provided by an unsecured lender to certain parent entities of the property owners. ACM owns slightly less than half of the unsecured lender entity and, therefore, provided slightly less than half of the unsecured lender financing. In addition, in connection with our equity investment, we received distributions totaling $0.6 million during both the three months ended June 30, 2018 and 2017 and $1.2 million and $1.3 million during the six months ended June 30, 2018 and 2017, respectively, which were recorded as income from equity affiliates. Separate from loans which we originated in June 2018, we provide limited (bad boy) guarantees for certain other debt controlled by Lexford. The bad boy guarantees may become a liability for us upon standard bad acts such as fraud or a material misrepresentation by Lexford or us. At June 30, 2018, this debt had an aggregate outstanding balance of $309.1 million and is scheduled to mature between 2019 and 2025.

Several of our executives, including our chief financial officer, general counsel and our chairman, chief executive officer and president, hold similar positions for ACM. Our chief executive officer and his affiliated entities (the Kaufman Entities) together beneficially own approximately 75% of the outstanding membership interests of ACM and certain of our employees and directors also hold an ownership interest in ACM. Furthermore, one of our directors serves as the trustee and co-trustee of two of the Kaufman Entities that hold membership interests in ACM. Upon the closing of the Acquisition in 2016, we issued 21,230,769 OP Units, each paired with one share of our Special Voting Preferred Shares. In December 2017, ACM distributed 5,780,348 OP Units to its members, which includes the Kaufman Entities and certain of our officers and employees. At June 30, 2018, ACM holds 5,349,053 shares of our common stock and 15,450,421 OP Units, which represents 23.2% of the voting power of our outstanding stock. Our Board of Directors approved a resolution under our charter allowing our chief executive officer and ACM, (which our chief executive officer has a controlling equity interest in), to own more than the 5% ownership interest limit of our common stock as stated in our amended charter.

Note 19 Segment Information

The summarized statements of income and balance sheet data, as well as certain other data, by segment are included in the following tables ($ in thousands). Specifically identifiable costs are recorded directly to each business segment. For items not specifically identifiable, costs have been allocated between the business segments using the most meaningful allocation methodologies, which was predominately direct labor costs (i.e., time spent working on each business segment). Such costs include, but are not limited to, compensation and employee related costs, selling and administrative expenses, management fees (through May 31, 2017 effective date of the full internalization of our management team and termination of the existing management agreement with ACM) and stock-based compensation.

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	Three Months Ended June 30, 2018			
	Structured Business	**Agency Business**	**Other / Eliminations (1)**	**Consolidated**
Interest income	$ 54,177	$ 5,118	$	$ 59,295
Interest expense	34,612	3,272		37,884
Net interest income	19,565	1,846		21,411
Other revenue:				
Gain on sales, including fee-based services, net		15,622		15,622
Mortgage servicing rights		17,936		17,936
Servicing revenue		22,808		22,808
Amortization of MSRs		(11,937)		(11,937)
Property operating income	2,964			2,964
Other income, net	117	(587)		(470)
Total other revenue	3,081	43,842		46,923
Other expenses:				
Employee compensation and benefits	6,749	20,066		26,815
Selling and administrative	3,497	5,376		8,873
Property operating expenses	2,856			2,856
Depreciation and amortization	444	1,401		1,845
Impairment loss on real estate owned	2,000			2,000
Provision for loss sharing (net of recoveries)		348		348
Provision for loan losses (net of recoveries)	(2,127)			(2,127)
Total other expenses	13,419	27,191		40,610
Income before income from equity affiliates and income taxes	9,227	18,497		27,724
Income from equity affiliates	1,387			1,387
Benefit from (provision for) income taxes	500	(4,999)		(4,499)
Net income	11,114	13,498		24,612
Preferred stock dividends	1,888			1,888
Net income attributable to noncontrolling interest			5,557	5,557
Net income attributable to common stockholders	$ 9,226	$ 13,498	$ (5,557)	$ 17,167

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June 30, 2018

	Three Months Ended June 30, 2017			
	Structured Business	Agency Business	Other / Eliminations (1)	Consolidated
Interest income	$ 29,917	$ 4,551	$	$ 34,468
Interest expense	16,712	2,737	962	20,411
Net interest income	13,205	1,814	(962)	14,057
Other revenue:				
Gain on sales, including fee-based services, net		18,830		18,830
Mortgage servicing rights		17,254		17,254
Servicing revenue		18,437		18,437
Amortization of MSRs		(11,828)		(11,828)
Property operating income	2,863			2,863
Other income, net	731	(1,552)		(821)
Total other revenue	3,594	41,141		44,735
Other expenses:				
Employee compensation and benefits	4,067	17,758		21,825
Selling and administrative	2,898	4,937		7,835
Property operating expenses	2,622			2,622
Depreciation and amortization	415	1,401		1,816
Impairment loss on real estate owned	1,500			1,500
Provision for loss sharing (net of recoveries)		532		532
Provision for loan losses (net of recoveries)	(1,760)			(1,760)
Management fee - related party	1,284	1,389		2,673
Total other expenses	11,026	26,017		37,043
Income before loss from equity affiliates and income taxes	5,773	16,938	(962)	21,749
Loss from equity affiliates	(3)			(3)
Provision for income taxes		(3,435)		(3,435)
Net income	5,770	13,503	(962)	18,311
Preferred stock dividends	1,888			1,888
Net income attributable to noncontrolling interest			4,494	4,494
Net income attributable to common stockholders	$ 3,882	$ 13,503	$ (5,456)	$ 11,929

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ARBOR REALTY TRUST, INC. AND SUBSIDIARIES

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June 30, 2018

	Six Months Ended June 30, 2018			
	Structured Business	Agency Business	Other / Eliminations (1)	Consolidated
Interest income	$ 101,413	$ 9,495	$	$ 110,908
Interest expense	64,817	6,125	329	71,271
Net interest income	36,596	3,370	(329)	39,637
Other revenue:				
Gain on sales, including fee-based services, net		33,815		33,815
Mortgage servicing rights		37,571		37,571
Servicing revenue		44,220		44,220
Amortization of MSRs		(23,802)		(23,802)
Property operating income	5,874			5,874
Other income, net	351	2,057		2,408
Total other revenue	6,225	93,861		100,086
Other expenses:				
Employee compensation and benefits	14,336	41,973		56,309
Selling and administrative	7,034	10,755		17,789
Property operating expenses	5,652			5,652
Depreciation and amortization	890	2,801		3,691
Impairment loss on real estae owned	2,000			2,000
Provision for loss sharing (net of recoveries)		821		821
Provision for loan losses (net of recoveries)	(1,802)			(1,802)
Total other expenses	28,110	56,350		84,460
Income before income from equity affiliates and income taxes	14,711	40,881	(329)	55,263
Income from equity affiliates	2,132			2,132
Benefit from income taxes	500	3,785		4,285
Net income	17,343	44,666	(329)	61,680
Preferred stock dividends	3,777			3,777
Net income attributable to noncontrolling interest			14,547	14,547
Net income attributable to common stockholders	$ 13,566	$ 44,666	$ (14,876)	$ 43,356

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	Six Months Ended June 30, 2017			
	Structured Business	Agency Business	Other / Eliminations (1)	Consolidated
Interest income	$ 58,426	$ 9,567	$	$ 67,993
Interest expense	31,953	5,971	1,924	39,848
Net interest income	26,473	3,596	(1,924)	28,145
Other revenue:				
Gain on sales, including fee-based services, net		38,001		38,001
Mortgage servicing rights		37,284		37,284
Servicing revenue		35,119		35,119
Amortization of MSRs		(23,716)		(23,716)
Property operating income	6,086			6,086
Other income, net	842	(2,549)		(1,707)
Total other revenue	6,928	84,139		91,067
Other expenses:				
Employee compensation and benefits	7,899	33,767		41,666
Selling and administrative	5,979	9,550		15,529
Property operating expenses	5,260			5,260
Depreciation and amortization	912	2,801		3,713
Impairment loss on real estate owned	2,700			2,700
Provision for loss sharing (net of recoveries)		2,212		2,212
Provision for loan losses (net of recoveries)	(2,456)			(2,456)
Management fee - related party	3,259	3,414		6,673
Total other expenses	23,553	51,744		75,297
Income before gain on extinguishment of debt, income from equity affiliates and income taxes	9,848	35,991	(1,924)	43,915
Gain on extinguishment of debt	7,116			7,116
Income from equity affiliates	760			760
Provision for income taxes		(9,536)		(9,536)
Net income	17,724	26,455	(1,924)	42,255
Preferred stock dividends	3,777			3,777
Net income attributable to noncontrolling interest			10,935	10,935
Net income attributable to common stockholders	$ 13,947	$ 26,455	$ (12,859)	$ 27,543

(1) Includes certain corporate expenses not allocated to the two reportable segments, such as financing costs associated with the Acquisition, as well as income allocated to the noncontrolling interest holders.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

June 30, 2018

	June 30, 2018			
	Structured Business	**Agency Business**	**Other / Eliminations**	**Consolidated**
Assets:				
Cash and cash equivalents	$ 78,997	$ 27,971	$	$ 106,968
Restricted cash	172,954	732		173,686
Loans and investments, net	3,064,798			3,064,798
Loans held-for-sale, net		311,487		311,487
Capitalized mortgage servicing rights, net		257,021		257,021
Securities held to maturity		50,342		50,342
Investments in equity affiliates	24,144			24,144
Goodwill and other intangible assets	12,500	106,465		118,965
Other assets	79,751	17,158		96,909
Total assets	$ 3,433,144	$ 771,176	$	$ 4,204,320
Liabilities:				
Debt obligations	$ 2,759,445	$ 307,656	$	$ 3,067,101
Allowance for loss-sharing obligations		31,402		31,402
Other liabilities	135,944	26,361		162,305
Total liabilities	$ 2,895,389	$ 365,419	$	$ 3,260,808

	December 31, 2017			
	Structured Business	**Agency Business**	**Other / Eliminations**	**Consolidated**
Assets:				
Cash and cash equivalents	$ 37,056	$ 67,318	$	$ 104,374
Restricted cash	139,398			139,398
Loans and investments, net	2,579,127			2,579,127
Loans held-for-sale, net		297,443		297,443
Capitalized mortgage servicing rights, net		252,608		252,608
Securities held-to-maturity, net		27,837		27,837
Investments in equity affiliates	23,653			23,653
Goodwill and other intangible assets	12,500	109,266		121,766
Other assets	66,227	13,512		79,739
Total assets	$ 2,857,961	$ 767,984	$	$ 3,625,945
Liabilities:				
Debt obligations	$ 2,189,700	$ 291,536	$ 50,000	$ 2,531,236
Allowance for loss-sharing obligations		30,511		30,511
Other liabilities	155,814	42,819	1,009	199,642
Total liabilities	$ 2,345,514	$ 364,866	$ 51,009	$ 2,761,389

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	**2017**	**2018**	**2017**
Origination Data:				
Structured Business				
New loan originations	$ 606,855	$ 437,915	$ 921,070	$ 583,933
Loan payoffs / paydowns	238,026	263,558	428,641	453,967

Agency Business				
Origination Volumes by Investor:				
Fannie Mae	$ 606,287	$ 669,897	$ 1,269,208	$ 1,566,446
Freddie Mac	434,789	317,490	742,940	552,522
FHA		32,878	60,738	170,814
CMBS/Conduit			16,233	21,370
Total	$ 1,041,076	$ 1,020,265	$ 2,089,119	$ 2,311,152
Total loan commitment volume	$ 1,079,478	$ 1,101,243	$ 2,123,193	$ 2,253,187
Loan Sales Data:				
Agency Business				
Fannie Mae	$ 579,851	$ 830,515	$ 1,308,246	$ 1,903,861
Freddie Mac	409,612	309,508	688,128	519,747
FHA	28,820	64,330	68,113	124,225
CMBS/Conduit			16,233	21,370
Total	$ 1,018,283	$ 1,204,353	$ 2,080,720	$ 2,569,203
Sales margin (fee-based services as a % of loan sales)	1.53%	1.56%	1.63%	1.48%
MSR rate (MSR income as a % of loan commitments)	1.66%	1.57%	1.77%	1.65%

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Key Servicing Metrics for Agency Business:	UPB of Servicing Portfolio	Wtd. Avg. Servicing Fee Rate (basis points)	Wtd. Avg. Life of Servicing Portfolio (in years)
		June 30, 2018	
Fannie Mae	$ 12,794,277	53.0	7.3
Freddie Mac	3,730,980	30.8	11.0
FHA	585,017	15.9	20.1
Total	$ 17,110,274	46.9	8.6
		December 31, 2017	
Fannie Mae	$ 12,502,699	53.6	6.9
Freddie Mac	3,166,134	29.5	10.5
FHA	537,482	16.5	19.6
Total	$ 16,206,315	47.7	8.1

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

You should read the following discussion in conjunction with the unaudited consolidated interim financial statements, and related notes and the section entitled Forward-Looking Statements included herein.

Overview

Through our Structured Business, we invest in a diversified portfolio of structured finance assets in the multifamily and commercial real estate markets, primarily consisting of bridge and mezzanine loans, including junior participating interests in first mortgages, preferred and direct equity. We may also directly acquire real property and invest in real estate-related notes and certain mortgage-related securities. Through our Agency Business, we originate, sell and service a range of multifamily finance products through GSE, HUD and CMBS programs. We retain the servicing rights and asset management responsibilities on substantially all loans we originate and sell under the GSE and HUD programs.

Through May 2017, we were externally managed and advised by ACM. Effective May 31, 2017, we terminated the existing management agreement with ACM and fully internalized our management team.

We conduct our operations to qualify as a REIT. A REIT is generally not subject to federal income tax on its REIT taxable income that is distributed to its stockholders, provided that at least 90% of its REIT taxable income is distributed and provided that certain other requirements are met.

Our operating performance is primarily driven by the following factors:

Net interest income earned on our investments. Net interest income represents the amount by which the interest income earned on our assets exceeds the interest expense incurred on our borrowings. If the yield on our assets increases or the cost or borrowings decreases, this will have a positive impact on earnings. However, if the yield earned on our assets decreases, or the cost of borrowings increases, this will have a negative impact on earnings. Net interest income is also directly impacted by the size and performance of our asset portfolio. We recognize the bulk of our net interest income from our Structured Business. Additionally, we recognize net interest income from loans originated through our Agency Business, which are generally sold within 60 days of origination.

Fees and other revenues recognized from originating, selling and servicing mortgage loans through the GSE and HUD programs. Revenue recognized from the origination and sale of mortgage loans consists of gains on sale of loans (net of any direct loan origination costs incurred), commitment fees, broker fees, loan assumption fees and loan origination fees. These gains and fees are collectively referred to as gain on sales, including fee-based services, net. We record income from MSRs at the time of commitment to the borrower, which represents the fair value of the expected net future cash flows associated with the rights to service mortgage loans that we originate, with the recognition of a corresponding asset upon sale. We also record servicing revenue which consists of fees received for servicing mortgage loans and earnings on escrows, net of amortization on the MSR assets recorded. These originations, selling and servicing fees and other revenues are included in our Agency Business results. Although we have long-established relationships with the GSE and HUD agencies, our operating performance would be negatively impacted if our business relationships with these agencies deteriorate.

Income earned from our structured transactions. Our structured transactions are primarily comprised of investments in equity affiliates, which represent unconsolidated joint venture investments formed to acquire, develop and/or sell real estate-related assets. Operating results from our unconsolidated equity investments can be difficult to predict and can vary significantly period-to-period. In addition, we periodically receive distributions from our equity investments. It is difficult to forecast the timing of such payments, which can be substantial in any given quarter. We account for structured transactions within our Structured Business.

Credit quality of our loans and investments, including our servicing portfolio. Effective portfolio management is essential to maximize the performance and value of our loan, investment and servicing portfolios. Maintaining the credit quality of the loans in our portfolios is of critical importance. Loans that do not perform in accordance with their terms may have a negative impact on earnings and liquidity.

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Significant Developments During the Second Quarter of 2018

Capital Markets Activity.

- In May 2018, we completed a public offering and sold 5,500,000 shares of our common stock for $8.72 per share, receiving net proceeds of $47.8 million; and
- In May 2018, we issued an additional $25.0 million of our 5.625% Notes and received net proceeds of $24.4 million.

Financing Activity.

- In June 2018, we closed our tenth collateralized securitization vehicle (CLO X) totaling $560.0 million of real estate related assets and cash, of which $441.0 million of investment grade notes were issued to third party investors and $53.2 million of below investment-grade notes and a $65.8 million equity interest in the portfolio were retained by us; and
- In June 2018, we completed the unwind of CLO V, redeeming $267.8 million of outstanding notes which were repaid primarily from refinancing the remaining assets within our existing financing facilities (including CLO X), as well as with cash held by CLO V, and expensed $1.3 million of deferred financing fees into interest expense.

Agency Business Activity.

- Loan originations and sales totaled $1.04 billion and $1.02 billion, respectively; and
- Our fee-based servicing portfolio grew 3% to $17.11 billion from $16.69 billion at March 31, 2018.

Structured Business Activity.

- Our Structured loan and investment portfolio grew 13% this quarter to $3.13 billion on loan originations totaling $606.9 million, partially offset by loan runoff totaling $238.0 million; and

- We recorded an impairment loss of $2.0 million on an office building we own (see Note 9 Real Estate Owned for details) and recorded a net loan loss recovery of $2.1 million, primarily related to the settlement of a non-performing preferred equity investment (see Note 3 Loans and Investments for details).

Subsequent Events.

- In July 2018, we completed the issuance and sale of $245.0 million of our 5.25% Convertible Notes through two private placements. We received proceeds totaling $237.2 million, net of the underwriter s discount and fees from these offerings. We used the net proceeds to exchange $99.8 million of our 6.50% Convertible Notes and $127.6 million of our 5.375% Convertible Notes for a combination of $219.8 million in cash (which includes accrued interest) and 6.8 million shares of our common stock to settle such exchanges (see Note 10 Debt Obligations for details); and

- In July 2018, we received approximately $11 million from the settlement of a litigation related to a prior investment, which will be reflected in our consolidated financial statements in the third quarter of 2018.

Current Market Conditions, Risks and Recent Trends

Our ability to execute our business strategy, particularly the growth of our Structured Business portfolio of loans and investments, is dependent on many factors, including our ability to access capital and financing on favorable terms. The past economic downturn had a significant negative impact on both us and our borrowers and limited our ability for growth. If similar economic conditions recur in the future, it may limit our options for raising capital and obtaining financing on favorable terms and may also adversely impact the creditworthiness of our borrowers which could result in their inability to repay their loans.

We rely on the capital markets to generate capital for financing the growth of our business. While we have been successful in generating capital through the debt and equity markets over the past several quarters, there can be no assurance that we will continue to have access to such markets. If we were to experience a prolonged downturn in the stock or credit markets, it could cause us to seek alternative sources of potentially less attractive financing, and may require us to adjust our business plan accordingly.

The Federal Reserve increased its targeted Federal Rate 75 basis points during 2017 and by another 50 basis points during the first six months of 2018. To date, we have not been significantly impacted by these increases and do not anticipate a significant decline in origination volume or profitability as interest rates remain at historically low levels. However, we cannot be certain that such a trend will continue as the number, timing, and magnitude of additional increases by the Federal Reserve, combined with other macroeconomic factors, may have a different effect on the commercial real estate market.

The Trump administration continues to focus on several issues that could impact interest rates and the U.S. economy, including the recently enacted Tax Reform. As a result of the Tax Reform, we expect to realize a benefit from the reduction of the corporate federal income tax rate from 35% to 21%, as our Agency Business operates in a TRS. While there is uncertainty regarding the specifics and timing of any future policy changes, any such actions could impact our business.

We are a national originator with Fannie Mae and Freddie Mac, and the GSEs remain the most significant providers of capital to the multifamily market. The Federal Housing Finance Agency (FHFA) released the GSE 2018 Scorecard (2018 Scorecard,) which established Fannie Mae s and Freddie Mac s loan origination caps at $35.00 billion (2018 Caps) each for the multifamily finance market, a $1.50 billion decrease from the 2017 loan origination caps. Affordable housing loans, loans to small multifamily properties, and manufactured housing rental community loans continue to be excluded from the 2018 Caps. In addition, the definition of the affordable loan exclusions has added an extremely-high cost market category, continues to encompass affordable housing in high- and very-high cost markets and allows for an exclusion from the 2018 Caps for the pro-rata portion of any loan on a multifamily property that includes affordable units. The 2018 Scorecard continues to provide FHFA the flexibility to review the estimated size of the multifamily loan origination market quarterly and proactively adjust the 2018 Caps accordingly. The 2018 Scorecard also continues to provide exclusions for loans to properties in underserved markets and for loans to finance certain energy or water efficiency improvements, however, to qualify for this exclusion, the projected annual energy or water savings must be at least 25%. Our originations with the GSEs are highly profitable executions as they provide significant gains from the sale of our loans, non-cash gains related to MSRs and servicing revenues, therefore, a decline in our GSE originations would negatively impact our financial results. We are unsure whether the FHFA will impose stricter limitations on GSE multifamily production volume in the future.

The commercial real estate markets continue to improve, but uncertainty remains as a result of global market instability, the current political climate and other matters and their potential impact on the U.S. economy and commercial real estate markets. In addition, the growth in multifamily rental rates seen over the past few years are showing signs of stabilizing. If real estate values decline and/or rent growth subsides, it may limit our new mortgage loan originations since borrowers often use increases in the value of, and revenues produced from, their existing properties to support the purchase or investment in additional properties. Declining real estate values may also significantly increase the likelihood that we will incur losses on our loans in the event of default because the value of our collateral may be insufficient to cover our cost on the loan. Any sustained period of increased payment delinquencies, foreclosures or losses could adversely affect both our net interest income from loans as well as our ability to originate, sell and securitize loans, which would significantly impact our results of operations, financial condition, business prospects and our ability to make distributions to our stockholders.

The economic environment over the past few years has seen continued improvement in commercial real estate values, which has generally increased payoffs and reduced the credit exposure in our loan and investment portfolio. We have made, and continue to make, modifications and extensions to loans when it is economically feasible to do so. In some cases, a modification is a more viable alternative to foreclosure proceedings when a borrower cannot comply with loan terms. In doing so, lower borrower interest rates, combined with non-performing loans, would lower our net interest margins when comparing interest income to our costs of financing. However, since 2013, the levels of modifications and delinquencies have generally declined as property values have increased and borrowers access to financing has improved. If the markets were to deteriorate and the U.S. experienced a prolonged economic downturn, we believe there could be additional loan modifications and delinquencies, which may result in reduced net interest margins and additional losses throughout our sector.

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Changes in Financial Condition

Assets Comparison of balances at June 30, 2018 to December 31, 2017:

Our Structured loan and investment portfolio balance was $3.13 billion and $2.65 billion at June 30, 2018 and December 31, 2017, respectively. This increase was primarily due to loan originations exceeding payoffs and other reductions by $492.4 million. See below for details.

Our portfolio had a weighted average current interest pay rate of 6.76% and 6.28% at June 30, 2018 and December 31, 2017, respectively. Including certain fees earned and costs associated with the structured portfolio, the weighted average current interest rate was 7.40% and 6.99% at June 30, 2018 and December 31, 2017, respectively. Advances on our financing facilities totaled $2.81 billion and $2.24 billion at June 30, 2018 and December 31, 2017, respectively, with a weighted average funding cost of 4.34% and 4.12%, respectively, which excludes financing costs. Including financing costs, the weighted average funding rate was 4.93% and 4.83% at June 30, 2018 and December 31, 2017, respectively.

Activity from our Structured Business portfolio was comprised of the following ($ in thousands):

	Three Months Ended June 30, 2018	Six Months Ended June 30, 2018
Loans originated	$ 606,855	$ 921,070
Number of loans	32	51
Weighted average interest rate	6.95%	7.16%
Loan payoffs / paydowns	$ 238,026	$ 428,641
Number of loans	22	42
Weighted average interest rate	6.70%	6.89%
Loans extended	$ 130,978	$ 189,378
Number of loans	9	13

Loans held-for-sale from the Agency Business increased $14.0 million, primarily related to loan originations exceeding loan sales during the six months ended June 30, 2018 as noted in the following table (in thousands). These loans are generally sold within 60 days from the loan origination date.

	Three Months Ended June 30, 2018		Six Months Ended June 30, 2018	
	Loan Originations	Loan Sales	Loan Originations	Loan Sales
Fannie Mae	$ 606,287	$ 579,851	$ 1,269,208	$ 1,308,246
Freddie Mac	434,789	409,612	742,940	688,128
FHA		28,820	60,738	68,113
CMBS/Conduit			16,233	16,233
Total	$ 1,041,076	$ 1,018,283	$ 2,089,119	$ 2,080,720

Securities held-to-maturity increased $22.5 million as a result of two additional purchases of B Piece bonds from Freddie Mac SBL program securitizations. See Note 7 Securities Held-to-Maturity for details.

Due from related party increased $9.5 million, primarily due to payoffs to be remitted by our affiliated servicing operations related to real estate transactions.

Other assets increased $9.8 million, primarily due to an increase in interest and other receivables from new loan originations, as well as an increase in deferred tax assets.

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Liabilities ***Comparison of balances at June 30, 2018 to December 31, 2017:***

Credit facilities and repurchase agreements increased $381.9 million, primarily due to funding of new structured loan activity.

Collateralized loan obligations increased $172.2 million primarily, due to the issuance of a new CLO, where we issued $441.0 million of notes to third party investors, partially offset by the unwind of a CLO totaling $267.8 million.

Senior unsecured notes increased $27.1 million, due to the issuance of $125.0 million aggregate principal amount of our 5.625% Notes, partially offset by the full redemption of our 7.375% Notes totaling $97.9 million.

In January 2018, we paid $50.0 million in full satisfaction of the related party financing entered into with ACM to finance a portion of the aggregate purchase price of the Acquisition.

Due to borrowers decreased $21.7 million, primarily due to a decrease in funds held on loan originations.

Other liabilities decreased $16.0 million, primarily due to the payment of incentive compensation during the first quarter of 2018, related to 2017 performance, and a decrease in current and deferred tax liabilities.

Equity

Distributions Dividends declared (on a per share basis) for the six months ended June 30, 2018 were as follows:

Common Stock		Preferred Stock			
			Dividend (1)		
Declaration Date	**Dividend**	**Declaration Date**	**Series A**	**Series B**	**Series C**
February 21, 2018	$ 0.21	February 2, 2018	$ 0.515625	$ 0.484375	$ 0.53125
May 2, 2018	$ 0.25	May 2, 2018	$ 0.515625	$ 0.484375	$ 0.53125

(1) The dividend declared on May 2, 2018 was for March 1, 2018 through May 31, 2018 and the dividend declared on February 2, 2018 was for December 1, 2017 through February 28, 2018.

Common Stock On August 1, 2018, the Board of Directors declared a cash dividend of $0.25 per share of common stock. The dividend is payable on August 31, 2018 to common stockholders of record as of the close of business on August 15, 2018.

Preferred Stock On August 1, 2018, the Board of Directors declared a cash dividend of $0.515625 per share of 8.25% Series A preferred stock; a cash dividend of $0.484375 per share of 7.75% Series B preferred stock; and a cash dividend of $0.53125 per share of 8.50% Series C preferred stock. These amounts reflect dividends from June 1, 2018 through August 31, 2018 and are payable on August 31, 2018 to preferred stockholders of record on August 15, 2018.

Deferred Compensation

We issued 329,028 shares of restricted stock to employees of ours, including our chief executive officer, 58,620 shares to the independent members of the Board of Directors and up to 381,503 performance-based restricted common stock units to our chief executive officer in the first quarter of 2018. See Note 16 Equity for details.

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Comparison of Results of Operations for the Three Months Ended June 30, 2018 and 2017

The following table provides our consolidated operating results ($ in thousands):

	Three Months Ended June 30, 2018	2017	Increase / (Decrease) Amount	Percent
Interest income	$ 59,295	34,468	$ 24,827	72%
Interest expense	37,884	20,411	17,473	86%
Net interest income	21,411	14,057	7,354	52%
Other revenue:				
Gain on sales, including fee-based services, net	15,622	18,830	(3,208)	(17)%
Mortgage servicing rights	17,936	17,254	682	4%
Servicing revenue, net	10,871	6,609	4,262	64%
Property operating income	2,964	2,863	101	4%
Other income, net	(470)	(821)	351	(43)%
Total other revenue	46,923	44,735	2,188	5%
Other expenses:				
Employee compensation and benefits	26,815	21,825	4,990	23%
Selling and administrative	8,873	7,835	1,038	13%
Property operating expenses	2,856	2,622	234	9%
Depreciation and amortization	1,845	1,816	29	2%
Impairment loss on real estate owned	2,000	1,500	500	33%
Provision for loss sharing (net of recoveries)	348	532	(184)	(35)%
Provision for loan losses (net of recoveries)	(2,127)	(1,760)	(367)	21%
Management fee - related party		2,673	(2,673)	nm
Total other expenses	40,610	37,043	3,567	10%
Income before income (loss) from equity affiliates and income taxes	27,724	21,749	5,975	27%
Income (loss) from equity affiliates	1,387	(3)	1,390	nm
Provision for income taxes	(4,499)	(3,435)	(1,064)	nm
Net income	24,612	18,311	6,301	34%
Preferred stock dividends	1,888	1,888		
Net income attributable to noncontrolling interest	5,557	4,494	1,063	24%
Net income attributable to common stockholders	$ 17,167	$ 11,929	$ 5,238	44%

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The following table presents the average balance of our Structured Business interest-earning assets and interest-bearing liabilities, associated interest income (expense) and the corresponding weighted average yields ($ in thousands):

	Three Months Ended June 30, 2018			2017		
	Average Carrying Value (1)	Interest Income / Expense	W/A Yield / Financing Cost (2)	Average Carrying Value (1)	Interest Income / Expense	W/A Yield / Financing Cost (2)
Structured Business interest-earning assets:						
Bridge loans	$ 2,641,796	$ 46,754	7.10%	$ 1,648,821	$ 27,414	6.67%
Preferred equity investments	190,228	2,592	9.12%	71,759	1,051	5.88%
Mezzanine / junior participation loans	79,093	4,326	13.15%	80,717	1,161	5.77%
Core interest-earning assets	2,911,117	53,672	7.40%	1,801,297	29,626	6.60%
Cash equivalents	220,153	505	0.92%	223,053	291	0.53%
Total interest-earning assets	$ 3,131,270	$ 54,177	6.94%	$ 2,024,350	$ 29,917	5.93%
Structured Business interest-bearing liabilities:						
CLO	$ 1,458,875	$ 17,307	4.76%	$ 982,499	$ 9,517	3.89%
Warehouse lines	481,010	5,485	4.57%	123,215	1,446	4.71%
Unsecured debt	378,950	8,637	9.14%	198,050	4,179	8.46%
Trust preferred	154,379	1,978	5.14%	154,336	1,570	4.08%
Debt fund	68,208	1,205	7.09%			
Total interest-bearing liabilities	$ 2,541,422	34,612	5.46%	$ 1,458,100	16,712	4.60%
Net interest income		$ 19,565			$ 13,205	

(1) Based on UPB for loans, amortized cost for securities and principal amount of debt.

(2) Weighted average yield calculated based on annualized interest income or expense divided by average carrying value.

Net Interest Income

The increase in interest income is primarily due to an increase of $24.3 million, or 81%, from our Structured Business, which was primarily the result of a 62% increase in our average core interest-earning assets, due to loan originations exceeding loan runoff, and a 12% increase in the average yield on core interest-earning assets, largely due to increases in the average LIBOR rate.

The increase in interest expense is primarily due to an increase of $17.9 million, or 107%, from our Structured Business, partially offset by a decrease of $1.0 million from the pay off in January 2018 of the seller financing entered into in connection with the Acquisition. The increase from our Structured Business was primarily due to a 74% increase in the average balance of our interest-bearing liabilities and a 19% increase in the average cost of our interest-bearing liabilities. The increase in the average debt balance was due to growth in our loan portfolio and the issuance of additional unsecured debt. The increase in the average cost of our interest-bearing liabilities was primarily due to $2.9 million of accelerated deferred financing costs recorded in the second quarter of 2018 related to the unwind of a CLO in June and the redemption of unsecured debt, along with an increase in the average LIBOR rate.

Agency Business Revenue

The decrease in gain on sales, including fee-based services, net was primarily due to a $186.1 million decrease in loan sales. Sales margin (gain on sales, including fee-based services, net as a percentage of loan sales volume) was flat at 1.53% this quarter compared to 1.56% in the second quarter of 2017.

The increase in servicing revenue, net was primarily due to an increase in our servicing portfolio and an increase in earnings on escrows. Our servicing portfolio increased 14% from $15.02 billion at June 30, 2017 to $17.11 billion at June 30, 2018. Our servicing revenue, net in the second quarter of 2018 and 2017 included $11.9 million and $11.8 million, respectively, of amortization expense.

Other Expenses

The increase in employee compensation and benefits expense is comprised of $2.7 million from our Structured Business and $2.3 million from our Agency Business. The increase in both businesses is primarily due to compensation expense recorded directly by each business associated with the employees that transferred to us as a result of the internalization of our management team in 2017. Such costs were previously charged through the management fee prior to the termination of our management agreement with ACM in May 2017. In addition, increases in headcount associated with each business s portfolio growth also contributed to the increase.

The increase in selling and administrative expenses is comprised of $0.6 million from our Structured Business and $0.4 million from our Agency Business. The increase from our Structured Business was primarily due to an increase in professional fees. The increase in our Agency Business was primarily due to increases in professional fees and rent expense.

Impairment losses on real estate owned were $2.0 million and $1.5 million for the three months ended June 30, 2018 and 2017, respectively. During these periods, we received market analysis which resulted in impairment losses on our real estate properties owned. See Note 9 Real Estate Owned for details.

The recovery for loan losses in the second quarter of 2018 was due to a $31.6 million settlement of a preferred equity investment with a carrying value of $29.1 million resulting in a $2.5 million recovery and a $0.9 million payment received on a written-off junior participation interest in an office building. These recoveries were partially offset by a $1.3 million provision recorded on a bridge loan. The recovery of loan losses for the three months ended June 30, 2017 was the result of a $1.8 million pay-off of a fully reserved mezzanine loan.

The decrease in management fee related party was due to the internalization of our management team and termination of the existing management agreement with ACM effective May 31, 2017.

Income (Loss) from Equity Investments

The increase in income (loss) from equity affiliates was primarily due to an increase in income from our investment in a residential mortgage banking business. In the three months ended June 30, 2018 we recorded income of $0.7 million from this investment, compared to a $0.7 million loss in the 2017 comparable period.

Provision for Income Taxes

In the three months ended June 30, 2018 and 2017, we recorded a tax provision of $4.5 million and $3.4 million, respectively. The provision for income taxes in the three months ended June 30, 2018 consisted of a current tax provision of $4.3 million and a deferred tax provision of $0.2 million and the provision for income taxes in the three months ended June 30, 2017 consisted of a current tax provision of $4.3 million and a deferred tax benefit of $0.9 million, respectively.

Net Income Attributable to Noncontrolling Interest

The noncontrolling interest relates to the 21,230,769 OP Units issued as part of the Acquisition, which represented 23.6% and 25.7% of our outstanding stock at June 30, 2018 and 2017, respectively.

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Comparison of Results of Operations for the Six Months Ended June 30, 2018 and 2017

The following table provides our consolidated operating results ($ in thousands):

	Six Months Ended June 30, 2018	Six Months Ended June 30, 2017	Increase / (Decrease) Amount	Increase / (Decrease) Percent
Interest income	$ 110,908	67,993	$ 42,915	63%
Interest expense	71,271	39,848	31,423	79%
Net interest income	39,637	28,145	11,492	41%
Other revenue:				
Gain on sales, including fee-based services, net	33,815	38,001	(4,186)	(11)%
Mortgage servicing rights	37,571	37,284	287	1%
Servicing revenue, net	20,418	11,403	9,015	79%
Property operating income	5,874	6,086	(212)	(3)%
Other income, net	2,408	(1,707)	4,115	nm
Total other revenue	100,086	91,067	9,019	10%
Other expenses:				
Employee compensation and benefits	56,309	41,666	14,643	35%
Selling and administrative	17,789	15,529	2,260	15%
Property operating expenses	5,652	5,260	392	7%
Depreciation and amortization	3,691	3,713	(22)	(1)%
Impairment loss on real estate owned	2,000	2,700	(700)	(26)%
Provision for loss sharing (net of recoveries)	821	2,212	(1,391)	(63)%
Provision for loan losses (net of recoveries)	(1,802)	(2,456)	654	(27)%
Management fee - related party		6,673	(6,673)	nm
Total other expenses	84,460	75,297	9,163	12%
Income before gain on extinguishment of debt, income from equity affiliates and income taxes	55,263	43,915	11,348	26%
Gain on extinguishment of debt		7,116	(7,116)	nm
Income from equity affiliates	2,132	760	1,372	181%
Benefit from (provision for) income taxes	4,285	(9,536)	13,821	nm
Net income	61,680	42,255	19,425	46%
Preferred stock dividends	3,777	3,777		
Net income attributable to noncontrolling interest	14,547	10,935	3,612	33%
Net income attributable to common stockholders	$ 43,356	$ 27,543	$ 15,813	57%

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The following table presents the average balance of our Structured Business interest-earning assets and interest-bearing liabilities, associated interest income (expense) and the corresponding weighted average yields ($ in thousands):

	Six Months Ended June 30,					
	2018			2017		
	Average Carrying Value (1)	Interest Income / Expense	W/A Yield / Financing Cost (2)	Average Carrying Value (1)	Interest Income / Expense	W/A Yield / Financing Cost (2)
Structured Business interest-earning assets:						
Bridge loans	$ 2,544,754	$ 87,739	6.95%	$ 1,635,394	$ 52,805	6.51%
Preferred equity investments	170,083	7,625	9.04%	68,069	2,151	6.37%
Mezzanine / junior participation loans	82,442	5,156	12.61%	96,567	3,006	6.28%
Core interest-earning assets	2,797,279	100,520	7.25%	1,800,030	57,962	6.49%
Cash equivalents	210,374	893	0.86%	179,977	464	0.52%
Total interest-earning assets	$ 3,007,653	$ 101,413	6.80%	$ 1,980,007	$ 58,426	5.95%
Structured Business interest-bearing liabilities:						
CLO	$ 1,441,318	$ 31,518	4.41%	$ 860,565	$ 16,385	3.84%
Warehouse lines	389,595	9,139	4.73%	200,395	3,957	3.98%
Unsecured debt	367,524	18,135	9.95%	195,984	8,301	8.54%
Trust preferred	154,379	3,728	4.87%	157,071	3,115	4.00%
Debt fund	68,162	2,297	6.80%			
Interest rate swaps					195	
Total interest-bearing liabilities	$ 2,420,978	64,817	5.40%	$ 1,414,015	31,953	4.56%
Net interest income		$ 36,596			$ 26,473	

(1) Based on UPB for loans, amortized cost for securities and principal amount of debt.

(2) Weighted average yield calculated based on annualized interest income or expense divided by average carrying value.

Net Interest Income

The increase in interest income is primarily due to an increase of $43.0 million, or 74%, from our Structured Business, which was primarily the result of a 55% increase in our average core interest-earning assets, due to loan originations exceeding loan runoff, and a 12% increase in the average yield on core interest-earning assets, largely due to increases in the average LIBOR rate.

The increase in interest expense is primarily due to an increase of $32.9 million, or 103%, from our Structured Business, partially offset by a decrease of $1.6 million from the pay off in January 2018 of the seller financing entered into in connection with the Acquisition. The increase from our Structured Business was primarily due to a 71% increase in the average balance of our interest-bearing liabilities and an 18% increase in the average cost of our interest-bearing liabilities. The increase in the average debt balance was due to growth in our loan portfolio and the issuance of additional CLOs, unsecured debt and the Debt Fund. The increase in the average cost of our interest-bearing liabilities was primarily due to $5.3 million of accelerated deferred financing costs recorded in 2018 related to the redemption of unsecured debt and the unwind of a CLO, along with an increase in the average LIBOR rate.

Agency Business Revenue

The decrease in gain on sales, including fee-based services, net was primarily due to a $488.5 million decrease in loan sales, partially offset by a 15 basis point increase in the sales margin from 1.48% to 1.63% in 2018. The increase in the sales margin was primarily due to an increase in Fannie Mae margins.

The increase in servicing revenue, net was primarily due to an increase in our servicing portfolio and an increase in earnings on escrows due to increases in the average LIBOR rate. Our servicing portfolio increased 14% from $15.02 billion at June 30, 2017 to $17.11 billion at June 30, 2018. Our servicing revenue, net in the six months ended June 30, 2018 and 2017 included $23.8 million and $23.7 million, respectively, of amortization expense.

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Other Income, Net

The increase in other income, net was comprised primarily of a $4.6 million increase from our Agency Business, which was due to changes in the fair value of our rate lock commitments. See Note 13 Fair Value for details.

Other Expenses

The increase in employee compensation and benefits expense is comprised of $8.2 million from our Agency Business and $6.4 million from our Structured Business. The increase in both businesses is primarily due to compensation expense recorded directly by each business associated with the employees that transferred to us as a result of the internalization of our management team in 2017. Such costs were previously charged through the management fee prior to the termination of our management agreement with ACM in May 2017. In addition, increases in headcount associated with each business s portfolio growth also contributed to the increase.

The increase in selling and administrative expenses is comprised of $1.2 million from our Agency Business and $1.1 million from our Structured Business. The increase in our Agency Business was primarily due to increases in professional fees and rent expense. The increase from our Structured Business was primarily due to an increase in professional fees, partially offset by a decrease in stock-based compensation expense.

Impairment losses on real estate owned were $2.0 million and $2.7 million for the six months ended June 30, 2018 and 2017, respectively. During these periods, we received market analysis which resulted in impairment losses on our real estate properties owned. See Note 9 Real Estate Owned for details.

The decrease in our provision for loss sharing was primarily related to runoff and higher Fannie Mae loan sales in the six months ended June 30, 2017.

The recovery for loan losses for the six months ended June 30, 2018 was due to a $31.6 million settlement of a preferred equity investment with a carrying value of $29.1 million resulting in a $2.5 million recovery and a $0.9 million payment received on a written-off junior participation interest in an office building. These recoveries were partially offset by a $1.7 million provision recorded on a bridge loan. The recovery of loan losses of $2.5 million for the six months ended June 30, 2017 was primarily due to the pay-off of a fully reserved mezzanine loan with a UPB of $1.8 million.

The decrease in management fee related party was due to the internalization of our management team and termination of the existing management agreement with ACM effective May 31, 2017.

Gain on Extinguishment of Debt

During the six months ended June 30, 2017, we purchased, at a discount, $20.9 million of our junior subordinated notes with a carrying value of $19.8 million and recorded a gain on extinguishment of debt of $7.1 million.

Income from Equity Investments

The increase in income from equity affiliates was primarily due to an increase in income from our investment in a residential mortgage banking business. In the six months ended June 30, 2018 we recorded income of $0.8 million from this investment, compared to a $0.6 million loss in the 2017 comparable period.

Benefit from (Provision for) Income Taxes

In the six months ended June 30, 2018 and 2017, we recorded a tax benefit of $4.3 million and a tax provision of $9.5 million, respectively. The benefit from income taxes in the six months ended June 30, 2018 consisted of a current tax provision of $8.8 million and a deferred tax benefit of $13.1 million, and the provision for income taxes in the six months ended June 30, 2017 consisted of a current tax provision of $8.6 million and a deferred tax provision of $0.9 million, respectively. The deferred tax benefit recorded in the six months ended June 30, 2018

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was due primarily to our payoff in January 2018 of the $50.0 million preferred equity interest entered into with ACM to finance a portion of the Acquisition purchase price.

The provision for income taxes in the six months ended June 30, 2018 includes the effect of the newly enacted corporate federal income tax rate of 21% on our Agency Business as a result of the Tax Reform. The provision for income taxes primarily represents federal and state taxes related to the Agency Business, which was acquired by the TRS Consolidated Group in July 2016.

Net Income Attributable to Noncontrolling Interest

The noncontrolling interest relates to the 21,230,769 OP Units issued as part of the Acquisition, which represented 23.6% and 25.7% of our outstanding stock at June 30, 2018 and 2017, respectively.

Liquidity and Capital Resources

Sources of Liquidity. Liquidity is a measure of our ability to meet our potential cash requirements, including ongoing commitments to repay borrowings, satisfaction of collateral requirements under the Fannie Mae DUS risk-sharing agreement and, as an approved designated seller/servicer of Freddie Mac s SBL program, operational liquidity requirements of the GSE agencies, fund new loans and investments, fund operating costs and distributions to our stockholders, as well as other general business needs. Our primary sources of funds for liquidity consist of proceeds from equity and debt offerings, debt facilities and cash flows from our operations. We closely monitor our liquidity position and believe our existing sources of funds and access to additional liquidity will be adequate to meet our liquidity needs.

While we have been successful in obtaining proceeds from debt and equity offerings, CLOs and certain financing facilities, current conditions in the capital and credit markets have and may continue to make certain forms of financing less attractive and, in certain cases, less available. Therefore we will continue to rely, in part, on cash flows provided by operating and investing activities for working capital.

To maintain our status as a REIT under the Internal Revenue Code, we must distribute annually at least 90% of our REIT taxable income. These distribution requirements limit our ability to retain earnings and thereby replenish or increase capital for operations. However, we believe that our capital resources and access to financing will provide us with financial flexibility and market responsiveness at levels sufficient to meet current and anticipated capital requirements.

Cash Flows. Cash flows provided by operating activities totaled $18.6 million during the six months ended June 30, 2018 and consisted primarily of net income, adjusted for noncash items, of $62.7 million, partially offset by net cash outflows of $15.9 million as a result of loan originations exceeding loan sales in our Agency Business and a period-over-period increases in other assets of $9.8 million and due from related party of $9.5 million. We had net cash outflows from loans-held-for-sale during the six months ended June 30, 2018 due to the timing of agency loan sales, as agency loans are generally sold within 60 days of origination.

Cash flows used in investing activities totaled $518.1 million during the six months ended June 30, 2018. Loan and investment activity (originations and payoffs/paydowns) comprise the bulk of our investing activities. Loan originations from our Structured Business totaling $875.2 million, net of payoffs and paydowns of $429.1 million, resulted in net cash outflows of $446.1 million. Cash used in investing activities also includes $58.6 million of cash used to fund holdbacks and reserves on our loans and investments and $21.6 million in cash payments to purchase B Piece bonds from SBL Program securitizations.

Cash flows provided by financing activities totaled $536.3 million during the six months ended June 30, 2018, and consisted primarily of $566.0 million of net proceeds from the issuances of a CLO and additional unsecured notes, net cash inflows of $382.8 million from debt facility activities (funded loan originations were greater than facility paydowns) and $55.9 million of net proceeds from a public offering of our common stock. These cash inflows were partially offset by outflows of $267.8 million for the redemption of CLO V, $97.9 million for the redemption of our 6.50% Convertible Notes, $50.0 million for full satisfaction of the seller financing related to the Acquisition of the Agency Business and $42.3 million distributed to our stockholders and OP Unit holders.

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Agency Business Requirements. The Agency Business is subject to supervision by certain regulatory agencies. Among other things, these agencies require us to meet certain minimum net worth, operational liquidity and restricted liquidity collateral requirements, purchase and loss obligations and compliance with reporting requirements. Our adjusted net worth and operational liquidity exceeded the agencies requirements as of June 30, 2018. Our restricted liquidity and purchase and loss obligations were satisfied with letters of credit totaling $47.0 million and $0.7 million of cash collateral. See Note 14 Commitments and Contingencies for details about our performance regarding these requirements.

We also enter into contractual commitments with borrowers providing rate lock commitments while simultaneously entering into forward sale commitments with investors. These commitments are outstanding for short periods of time (generally less than 60 days) and are described in Note 12 Derivative Financial Instruments and Note 13 Fair Value.

Debt Instruments. We maintain various forms of short-term and long-term financing arrangements. Borrowings underlying these arrangements are primarily secured by a significant amount of our loans and investments and substantially all of our loans held-for-sale. The following is a summary of our debt facilities ($ in thousands):

	June 30, 2018			
Debt Instruments	**Commitment**	**UPB (1)**	**Available**	**Maturity Dates**
Structured Business				
Credit facilities and repurchase agreements	$ 947,968	$ 605,963	$ 342,005	2018 - 2021
Collateralized loan obligations (2)	1,609,524	1,609,524		2018 - 2023
Debt Fund (2)	70,000	70,000		2019 - 2022
Senior unsecured notes	125,000	125,000		2023
Convertible unsecured senior notes	243,750	243,750		2019 - 2020
Junior subordinated notes	154,336	154,336		2034 - 2037
Structured transaction business total	3,150,578	2,808,573	342,005	
Agency Business				
Credit facilities (3)	1,000,000	307,811	692,189	2018
Consolidated total	$ 4,150,578	$ 3,116,384	$ 1,034,194	

(1) Excludes the impact of deferred financing costs.

(2) Maturity dates represent the weighted average remaining maturity based on the underlying collateral as of June 30, 2018.

(3) The ASAP agreement we have with Fannie Mae has no expiration date.

The debt facilities, including their restrictive covenants, are described in Note 10 Debt Obligations.

Contractual Obligations. During the six months ended June 30, 2018, the following significant changes were made to our contractual obligations disclosed in our 2017 Annual Report:

- Closed CLO X issuing $441.0 million of investment grade notes to third party investors;
- Unwound CLO V redeeming $267.8 million of outstanding notes;
- Subsequently issued $245.0 million of 5.25% Convertible Notes (which were used to repurchase substantially all of our 6.50% Convertible Notes and 5.375% Convertible Notes totaling $227.4 million);
- Issued $125.0 million of our 5.625% Notes (which were substantially used to redeem all of our 7.375% Notes totaling $97.9 million);
- Repaid the $50.0 million related party financing; and
- Closed new and modified existing credit facilities.

See Note 10 Debt Obligations for details and refer to Note 14 Commitments and Contingencies for a description of our debt maturities by year and unfunded commitments as of June 30, 2018.

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Off-Balance Sheet Arrangements. At June 30, 2018, we had no off-balance sheet arrangements.

Derivative Financial Instruments

We enter into derivative financial instruments in the normal course of business through the origination and sale of mortgage loans and the management of potential loss exposure caused by fluctuations of interest rates. See Note 12 Derivative Financial Instruments for details about our derivative financial instruments.

Critical Accounting Policies

Please refer to Note 2 Basis of Presentation and Significant Accounting Policies of the Notes to Consolidated Financial Statements in our 2017 Annual Report for a discussion of our critical accounting policies. During the six months ended June 30, 2018, there were no material changes to these policies.

Non-GAAP Financial Measures

Funds from Operations and Adjusted Funds from Operations. We present funds from operations (FFO) and adjusted funds from operations (AFFO) because we believe they are important supplemental measures of our operating performance in that they are frequently used by analysts, investors and other parties in the evaluation of REITs. The National Association of Real Estate Investment Trusts, or NAREIT, defines FFO as net income (loss) attributable to common stockholders (computed in accordance with GAAP), excluding gains (losses) from sales of depreciated real properties, plus impairments of depreciated real properties and real estate related depreciation and amortization, and after adjustments for unconsolidated ventures.

We define AFFO as funds from operations adjusted for accounting items such as non-cash stock-based compensation expense, income from MSRs, changes in fair value of certain derivatives that temporarily flow through earnings, amortization and write-offs of MSRs, deferred tax benefit and amortization of convertible senior notes conversion options. We also add back one-time charges such as acquisition costs and impairment losses on real estate and gains on sales of real estate. We are generally not in the business of operating real estate property and had obtained real estate by foreclosure or through partial or full settlement of mortgage debt related to our loans to maximize the value of the collateral and minimize our exposure. Therefore, we deem such impairment and gains on real estate as an extension of the asset management of our loans, thus a recovery of principal or additional loss on our initial investment.

FFO and AFFO are not intended to be an indication of our cash flow from operating activities (determined in accordance with GAAP) or a measure of our liquidity, nor is it entirely indicative of funding our cash needs, including our ability to make cash distributions. Our calculation of FFO and AFFO may be different from the calculations used by other companies and, therefore, comparability may be limited.

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FFO and AFFO are as follows ($ in thousands, except share and per share data):

	Three Months Ended June 30, 2018	Three Months Ended June 30, 2017	Six Months Ended June 30, 2018	Six Months Ended June 30, 2017
Net income attributable to common stockholders	$ 17,167	$ 11,929	$ 43,356	$ 27,543
Adjustments:				
Net income attributable to noncontrolling interest	5,557	4,494	14,547	10,935
Impairment loss on real estate owned	2,000	1,500	2,000	2,700
Depreciation - real estate owned	178	169	356	419
Depreciation - investments in equity affiliates	125	101	250	203
Funds from operations (1)	$ 25,027	$ 18,193	$ 60,509	$ 41,800
Adjustments:				
Income from mortgage servicing rights	(17,936)	(17,254)	(37,571)	(37,284)
Impairment loss on real estate owned	(2,000)	(1,500)	(2,000)	(2,700)
Deferred tax provision (benefit)	185	(890)	(13,135)	937
Amortization and write-offs of MSRs	17,203	14,932	33,879	30,213
Depreciation and amortization	2,255	1,873	4,511	3,741
Net loss (gain) on changes in fair value of derivatives	587	1,552	(2,057)	2,549
Stock-based compensation	1,100	682	3,645	2,986
Adjusted funds from operations (1)	$ 26,421	$ 17,588	$ 47,781	$ 42,242
Diluted FFO per share (1)	$ 0.28	$ 0.23	$ 0.69	$ 0.55
Diluted AFFO per share (1)	$ 0.29	$ 0.22	$ 0.55	$ 0.55
Diluted weighted average shares outstanding (1)	90,055,170	79,064,503	87,420,543	76,365,118

(1) Amounts are attributable to common stockholders and OP Units holders. The OP Units are redeemable for cash, or at our option for shares of our common stock on a one-for-one basis.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We disclosed a quantitative and qualitative analysis regarding market risk in the Management s Discussion and Analysis of Financial Condition and Results of Operations included in our 2017 Annual Report. That information is supplemented by the information included above in Item 2 of this report. Other than the developments described thereunder, there have been no material changes in our quantitative and qualitative exposure to market risk since December 31, 2017.

The following table projects the potential impact on interest income and interest expense for a 12-month period, assuming an instantaneous increase or decrease of both 25 and 50 basis points in LIBOR (in thousands).

	Assets (Liabilities) Subject to Interest Rate Sensitivity (1)	25 Basis Point Increase	25 Basis Point Decrease (2)	50 Basis Point Increase	50 Basis Point Decrease (2)

Interest income from loans and investments	$	3,134,879	$	6,970	$	(6,494)	$	13,967	$	(12,623)
Interest expense from debt obligations		(2,808,573)		6,092		(6,092)		12,183		(12,183)
Total net interest income			$	878	$	(402)	$	1,784	$	(440)

(1) Represents the UPB of our loan portfolio and the principal balance of our debt.

(2) The quoted one-month LIBOR rate was 2.09% as of June 30, 2018.

Our Agency Business originates, sells and services a range of multifamily finance products with Fannie Mae, Freddie Mac and HUD. Our loans held-for-sale to Fannie Mae, Freddie Mac and HUD are not currently exposed to interest rate risk during the loan commitment, closing and delivery process. The sale or placement of each loan to an investor is negotiated prior to closing on the loan with the borrower, and the sale or placement is generally effectuated within 60 days of closing. The coupon rate for the loan is set after we established the interest rate with the investor.

In addition, the fair value of our MSRs is subject to market risk since a significant driver of the fair value of these assets is the discount rates. A 100 basis point increase in the weighted average discount rate would decrease the fair value of our MSRs by approximately $9.7 million as of June 30, 2018, while a 100 basis point decrease would increase the fair value by approximately $10.3 million.

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Item 4. Controls and Procedures

Management, with the participation of our chief executive officer and chief financial officer, has evaluated the effectiveness of our disclosure controls and procedures at June 30, 2018. Based on this evaluation, our chief executive officer and chief financial officer have concluded that our disclosure controls and procedures were effective as of June 30, 2018.

There were no changes in our internal control over financial reporting during the quarter ended June 30, 2018 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

We are not involved in any material litigation nor, to our knowledge, is any material litigation threatened against us other than the litigation described in Note 14 Commitments and Contingencies. We have not made a loss accrual for any litigation because we believe that it is not probable that a loss has been incurred and an amount cannot be reasonably estimated.

Item 1A. Risk Factors

There have been no material changes to the risk factors set forth in Item 1A of our 2017 Annual Report.

Item 6. Exhibits

Exhibit #	Description
3.1	Articles of Incorporation of Arbor Realty Trust, Inc. *
3.2	Amended and Restated Bylaws of Arbor Realty Trust, Inc. **
4.1	Indenture, dated as of March 13, 2018, between Arbor Realty Trust, Inc. and U.S. Bank National Association, as trustee. ***
10.1	Indenture, dated June 14, 2018, by and between Arbor Realty Commercial Real Estate Notes 2018-FL1, LTD., Arbor Realty Commercial Real Estate Notes 2018-FL1 LLC, Arbor Realty SR, Inc. and U.S. Bank National Association.

10.2	Mortgage Asset Purchase Agreement, dated June 14, 2018, by and between Arbor Realty SR, Inc. and Arbor Realty Commercial Real Estate Notes 2018-FL1, LTD.
10.3	Placement Agreement, dated May 23, 2018, by and between Arbor Realty Commercial Real Estate Notes 2018-FL1, LTD., Arbor Realty Commercial Real Estate Notes 2018-FL1 LLC and J.P. Morgan Securities LLC.
31.1	Certification of Chief Executive Officer pursuant to Exchange Act Rule 13a-14.
31.2	Certification of Chief Financial Officer pursuant to Exchange Act Rule 13a-14.
32	Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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Exhibit #	Description
101.1	Financial statements from the Quarterly Report on Form 10-Q of Arbor Realty Trust, Inc. for the quarter ended June 30, 2018, filed on August 3, 2018, formatted in XBRL: (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Income, (iii) the Consolidated Statements of Comprehensive Income, (iv) the Consolidated Statement of Changes in Equity, (v) the Consolidated Statements of Cash Flows and (vi) the Notes to Consolidated Financial Statements.

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* Incorporated by reference to the Registrant s Registration Statement on Form S-11 (Registration No. 333-110472), as amended, filed November 13, 2003.

** Incorporated by reference to Exhibit 3.1 of the Registrant s Current Report on Form 8-K (No. 001-32136) filed August 4, 2017.

*** Incorporated by reference to Exhibit 4.1 of the Registrant s Current Report on Form 8-K (No. 001-32136) filed March 13, 2018.

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SIGNATURES

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

	ARBOR REALTY TRUST, INC.	
Date: August 3, 2018	By:	/s/ Ivan Kaufman Ivan Kaufman Chief Executive Officer
Date: August 3, 2018	By:	/s/ Paul Elenio Paul Elenio Chief Financial Officer