

ACCREDITED HOME LENDERS HOLDING CO

Form 10-Q

September 18, 2007

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2007

or

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

For the transition period from to

Commission File Number 001-32275

ACCREDITED HOME LENDERS HOLDING CO.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of

incorporation or organization)

04-3669482
(I.R.S. Employer

Identification No.)

15253 Avenue of Science

San Diego, California 92128

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(Address of principal executive offices) (Zip Code)

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

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

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, \$.001 Par Value	NASDAQ

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

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

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

Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐

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

The number of outstanding shares of the registrant's common stock as of August 31, 2007 was 25,154,069.

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SERVICE MARKS AND TRADE NAMES

Accredited Home Lenders, Inc. ("AHL"), a wholly owned subsidiary of the registrant, owns the following service marks and trademarks for its United States operations: Accredited Home Lenders®, Accredited Home Lenders® and logo, Home Funds Direct® and logos, Axiom Financial Services®, Axiom Financial Services® and logo, FRONTDOOR®, FRONTDOOR® and logo, InzuraSM, InzuraSM and logo, Common Sense for Uncommon Loans®, AAMES INVESTMENT®, INFORMEDBROKER®, LendingBridgeSM and logo, and Aames Direct®, Aames Capital®, Aames®, Aames Investment®, and Aames Home Loan®; and the following service marks and trademarks for the registrant's Canadian operations: Accredited Home Lenders Canada®, Accredited Home Lenders® and logo, Common Sense for Uncommon Loans^{MC}, Prêteurs Résidentiels Accrédités Canada^{MC}, and We Give You Credit For Being Human®.

FORWARD-LOOKING STATEMENTS

This report contains certain forward-looking statements. When used in this report, statements which are not historical in nature, including the words anticipate, estimate, should, expect, believe, intend and similar expressions are intended to identify forward-looking statements. These statements include statements containing expectations regarding the integration of Aames Investment Corporation and other internal matters, external development and projections of revenues, earnings or losses, capital expenditures, dividends, capital structure or other financial terms.

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

our ability to operate at a profit, or sustain consecutive periods of net losses and remain a going concern, due to adverse market conditions and other factors beyond our control;

our ability to maintain sufficient liquidity to sustain operations;

whether or not our pending merger with an affiliate of Lone Star Fund V (U.S.), L.P. is consummated;

our ability to realize cost savings, synergies and economies of scale from our acquisition of Aames Investment Corporation and our ability to improve profitability of the combined operations;

repurchase rates on the mortgage loans that we sell or securitize, which may reduce our cash available for operations and liquidity;

acceleration of debt repayment obligations due to a failure to meet the covenants contained in our credit facilities, including covenants on minimum profitability, interest coverage, liquidity, and net worth requirements as well as limitations on total indebtedness;

the degree and nature of our competition, including without limitation their impact on the rates that we are able to charge our borrowers;

changes in demand for, or value of, mortgage loans due to the attributes, mix and performance of the mortgage loans we originate; the characteristics of our borrowers; and fluctuations in the real estate market, the interest rates or the market in which we sell or

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securitize our mortgage loans;

a general deterioration in economic or political conditions, including without limitation any slow down in the national and/or local real estate markets;

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

changes in government regulations that affect our ability to originate and service mortgage loans;

changes in the credit markets, which affect our ability to borrow money to originate mortgage loans;

our ability to employ and retain qualified employees;

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

our ability to adapt to and implement technological changes; and

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the other factors referenced in this report, including, without limitation, under the sections entitled ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, and ITEM 1A. Risk Factors.

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

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In this Form 10-Q, unless the context requires otherwise, Accredited, Company, we, our, and us means Accredited Home Lenders Holding Co. and its subsidiaries.

PART I**ITEM 1. Financial Statements****ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

(in thousands, except share data)

	March 31, 2007 (Unaudited)	December 31, 2006
ASSETS		
Cash and cash equivalents	\$ 371,606	\$ 173,113
Restricted cash	111,337	96,758
Accrued interest receivable	47,508	68,128
Mortgage loans held for sale, net	419,488	2,073,268
Mortgage loans held for investment, net of allowance of \$136,647 and \$138,250, respectively	7,645,895	8,478,682
Derivative assets, including margin account	24,527	83,148
Deferred income tax asset, net	120,798	120,560
Real estate owned, net	130,658	104,818
Prepaid expenses and other assets	103,700	103,270
Furniture, fixtures and equipment, net	46,671	47,301
Total assets	\$ 9,022,188	\$ 11,349,046
LIABILITIES AND STOCKHOLDERS EQUITY		
LIABILITIES:		
Credit facilities-loans held for sale	\$ 430,194	\$ 2,786,077
Securitization and other financing	8,005,282	7,642,842
Income taxes payable, current	15,045	
Accrued expenses and other liabilities	191,392	266,056
Total liabilities	8,641,913	10,694,975
COMMITMENTS AND CONTINGENCIES (Note 14)		
MINORITY INTEREST IN REIT SUBSIDIARY	97,922	97,922
STOCKHOLDERS EQUITY:		
Preferred stock, \$.001 par value; authorized 5,000,000 shares; no shares issued or outstanding		
Common stock, \$.001 par value; authorized 75,000,000 shares; issued and outstanding 25,094,111 shares and 25,026,234 shares, respectively	25	25
Additional paid-in capital	315,241	311,683
Accumulated other comprehensive income (loss)	(10,798)	6,388
Retained earnings (accumulated deficit)	(22,115)	238,053
Total stockholders equity	282,353	556,149

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Total liabilities and stockholders' equity	\$ 9,022,188	\$ 11,349,046
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The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF OPERATIONS****(in thousands, except per share amounts) (Unaudited)**

	Three Months Ended March 31,	
	2007	2006
REVENUES:		
Interest income	\$ 195,260	\$ 194,458
Interest expense	(136,876)	(112,136)
Net interest income	58,384	82,322
Provision for losses on mortgage loans held for investment	(25,324)	(16,537)
Net interest income after provision	33,060	65,785
Gain (loss) on sale of mortgage loans, net	(178,878)	70,552
Mortgage loan servicing income	2,908	3,407
Other income	8,345	1,950
Total net revenues	(134,565)	141,694
OPERATING EXPENSES:		
Salaries, wages and benefits	64,612	47,526
General and administrative expenses	21,127	15,154
Occupancy	15,234	6,398
Advertising and promotion	7,834	5,154
Depreciation and amortization	4,690	4,427
Total operating expenses	113,497	78,659
Income (loss) before income taxes and minority interest	(248,062)	63,035
Income tax provision	9,611	24,717
Minority interest dividends on preferred stock of subsidiary	2,495	2,495
Net income (loss)	\$ (260,168)	\$ 35,823
Earnings (loss) per common share:		
Basic	\$ (10.29)	\$ 1.66
Diluted	\$ (10.29)	\$ 1.61
Weighted average shares outstanding:		
Basic	25,282	21,553
Diluted	25,282	22,279

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

Table of Contents**ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS****(in thousands) (Unaudited)**

	Three Months Ended March 31,	
	2007	2006
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	\$ (260,168)	\$ 35,823
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	4,690	4,427
Provision for losses on mortgage loans held for investment	25,324	16,537
Provision for losses on repurchases and premium recapture	24,394	3,154
Minority interest dividends paid on preferred stock of subsidiary	2,495	2,495
Deferred income tax provision (benefit)	2,969	(5,298)
Unrealized (gain) loss on derivatives	(13,810)	9,702
Adjustment into earnings for gain on derivatives from other comprehensive income	(7,162)	(7,071)
Stock-based compensation expense	3,451	2,141
Excess tax benefit from stock-based payment arrangements	(238)	(2,355)
Other	2,240	2,818
Changes in operating assets and liabilities:		
Restricted cash	(14,579)	(6,200)
Mortgage loans held for sale originated, net of fees	(1,858,931)	(3,574,352)
Cost of mortgage loans sold, net of fees	3,574,026	3,102,526
Principal payments received and other changes in mortgage loans held for sale	32,294	39,606
Accrued interest receivable	20,620	(2,123)
Derivative assets, including margin account	60,796	12,756
Prepaid expenses and other assets	11,716	(7,945)
Income taxes payable	15,045	(53,297)
Accrued expenses and other liabilities	(112,178)	(1,077)
Net cash provided by (used in) operating activities	1,512,994	(427,733)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Principal payments received and other changes on mortgage loans held for investment	680,286	522,647
Capital expenditures	(4,055)	(8,461)
Net cash provided by investing activities	676,231	514,186
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net changes in credit facilities loans held for sale	(2,372,319)	(603,397)
Net proceeds from issuance of asset backed commercial paper		71,595
Proceeds from issuance of securitization and other financing, net of fees	775,819	997,727
Payments on securitization and other financing	(673,297)	(531,230)
Net proceeds from issuance of common stock through employee stock plans	64	1,550
Net proceeds from issuance of term debt and warrants, net of fees	226,700	
Net proceeds from issuance of trust preferred securities	54,209	
Excess tax benefit from stock-based payment arrangements	238	2,355
Payment by consolidated subsidiary of preferred stock dividends	(2,495)	(2,495)
Net cash used in financing activities	(1,991,081)	(63,895)
Effect of exchange rate changes on cash	349	326

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Net increase in cash and cash equivalents	198,493	22,884
Beginning balance, cash and cash equivalents	173,113	44,714
Ending balance, cash and cash equivalents	\$ 371,606	\$ 67,598

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

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ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The consolidated financial statements include the accounts of Accredited Home Lenders Holding Co. (Accredited or AHLHC), a Delaware corporation, and its wholly owned subsidiaries Accredited Home Lenders, Inc. (AHL), Accredited Home Lenders Canada, Inc., Vendor Management Services, LLC d/b/a Inzura Settlement Services, AHL's wholly owned subsidiaries Accredited Mortgage Loan REIT Trust, herein reported separately (the REIT), Aames Capital Corporation, and Inzura Insurance Services, Inc. (collectively referred to as Accredited). All intercompany balances and transactions are eliminated in consolidation. The accompanying consolidated financial statements included in this report for Accredited have been prepared, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures, normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles, have been condensed or omitted pursuant to such rules and regulations. These financial statements should be read in conjunction with the audited financial statements and the related notes included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2006.

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

AHLHC operates in the highly volatile non-prime mortgage sector. In 2007, the non-prime mortgage sector has been characterized by turmoil and deteriorating conditions including the withdrawal of credit by warehouse credit lenders, bankruptcy of multiple industry participants, tightening of underwriting standards, increased mortgage delinquencies and defaults by borrowers, reduced origination of non-prime mortgages, downgrades by credit rating agencies, and reductions in personnel, among others. In response to these challenging conditions and to preserve liquidity, during 2007, AHLHC completed the sale of substantially all of its mortgage loans held for sale as of March 16, 2007 totaling approximately \$2.7 billion, borrowed \$230 million under a five-year term loan facility, restructured or terminated many credit facilities, terminated its asset-backed commercial paper program, acquired new warehouse credit facilities, and effected significant reductions in personnel. Also, beginning September 2007, Accredited substantially suspended U.S. mortgage origination operations pending the return of market conditions under which non-prime mortgage loans can be originated and sold or securitized at a profit.

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

Accredited's business is the origination, financing, securitizing, servicing and selling of non-prime mortgage loans secured by residential real estate. Accredited's business focuses on borrowers who may not meet conforming underwriting guidelines because of higher mortgage loan-to-value ratios, the nature or absence of income documentation, limited credit histories, high levels of consumer debt, or past credit difficulties. Accredited originates mortgage loans primarily based upon the borrower's willingness and ability to repay the mortgage loan and the adequacy of the collateral. As noted above, beginning September 2007, Accredited substantially suspended U.S. mortgage origination operations.

Securitizations of non-prime mortgage loans originated by AHL have generally been executed through AHL's subsidiary, the REIT. In such securitizations, AHL contributes the mortgage loans to the REIT as capital and assumes the AHL's related financing obligations, and the loans are accounted for at AHL's carrying value.

AHL also provides operating facilities, administration and mortgage loan servicing for the REIT. The REIT is, therefore, economically and operationally dependent on AHL, and, as such, the REIT's results of operation or financial condition would not be indicative of the conditions

that would have existed for its results of operations or financial condition if it had operated as an unaffiliated entity.

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ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Use of Estimates

The preparation of our financial statements requires us to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Although we base our estimates and assumptions on historical experience and on various other factors that we believe to be reasonable under the circumstances, our management exercises significant judgment in the final determination of our estimates. Actual results may differ from these estimates. The following areas require significant judgments by management:

lower of cost or market valuation allowance (LOCOM)

provisions for losses, reserves and repurchase reserves

interest rate risk, derivatives and hedging strategies

income taxes

mortgage loan sales

Cash and Cash Equivalents

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

Mortgage Banking Activities

Accredited is in the business of originating, financing, securitizing, servicing and selling mortgage loans secured by residential real estate. Accredited recognizes interest income on mortgage loans held for sale and investment from the time that it originates the mortgage loan until the time the mortgage loans are sold. Interest income is also recognized over the life of the mortgage loans that Accredited has securitized in structures that require financing treatment. These securitizations are structured legally as sales, but for accounting purposes are treated as financings under SFAS No. 140 *Accounting for Transfer and Servicing of Financial Assets and Extinguishment of Liabilities* a replacement of FASB Statement No. 125 (SFAS No. 140). Gains on sale of mortgage loans are recognized upon the sale of mortgage loans for a premium to various third-party investors under purchase and sale agreements. Mortgage loan sales may be either on a servicing retained or released basis. Mortgage loan servicing income represents fees from interim servicing for whole mortgage loan buyers, and ancillary servicing revenue for mortgage loans that Accredited securitizes net of external servicing costs, if any. We do not recognize mortgage loan servicing income on our mortgage loans held for investment.

Mortgage Loans Held for Sale

Mortgage loans held for sale are carried at the lower of amortized cost or fair value (LOCOM). We estimate fair value by evaluating a variety of market indicators including recent trades, outstanding commitments or current investor yield requirements.

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Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from Accredited, (2) the transferee has the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) Accredited does not maintain effective control over the transferred assets through either (a) an agreement that entitles and obligates Accredited to repurchase or redeem them before their maturity or (b) the ability to unilaterally cause the holder to return specific assets.

Gains or losses resulting from loan sales are recognized at the time of sale, based on the difference between the net sales proceeds and the carrying value of the loans sold.

Accredited's sales of mortgage loans are subject to standard mortgage industry representations and warranties, material violations of which may require Accredited to repurchase one or more mortgage loans. Additionally, certain whole mortgage loan sale contracts include provisions requiring Accredited to repurchase a mortgage loan if a borrower fails to make one or more of the first mortgage loan payments due on the mortgage loan. In addition, an investor may request that Accredited refund a portion of the premium paid on the sale of mortgage loans if a mortgage loan is prepaid in full within a certain amount of time following the date of sale. Accredited records a provision for estimated repurchases and premium recapture on mortgage loans sold, which is charged to gain on sale of mortgage loans.

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ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Mortgage Loans Held for Investment, Securitization Financing and Provision for Losses

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

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

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

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

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

Derivative Financial Instruments

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

Fair Value Hedges

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Accredited designates certain derivative financial instruments as hedge instruments under SFAS No. 133, and, at trade date, these instruments and their hedging relationship are identified, designated and documented. Accredited has implemented fair value hedge accounting on its mortgage loans held for sale, whereby certain derivatives are designated as a hedge of the fair value of mortgage loans held for sale. This process includes linking derivatives to specific assets or liabilities on the balance sheet. Accredited also assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives used in hedge transactions are highly effective in offsetting changes in fair values of hedged items. Changes in the fair value of such derivative instruments and changes in the fair value of the hedged assets, which are determined to be effective, are recorded as a component of gain on sale in the period of change. When it is determined that a derivative is not highly effective as a hedge or that it has ceased to be a highly effective hedge, Accredited discontinues hedge accounting. If

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ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

hedge accounting is discontinued because it is determined that the relationship between the derivative and the underlying asset no longer qualifies as an effective hedge, the derivative will continue to be recorded on the balance sheet at its fair value. For terminated hedges or hedges no longer qualifying as effective, the formerly hedged asset will no longer be adjusted for changes in fair value and any previously recorded adjustment to the hedged asset will be included in the carrying basis. These amounts will be included in results of operations at the time we sell the loans. Should the hedge prove to be perfectly effective, the current period net impact to earnings would be minimal. Accordingly, the net amount recorded in the statement of operations relating to fair value hedge accounting is referred to as hedge ineffectiveness.

Cash Flow Hedges

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

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

Furniture, Fixtures and Equipment

Furniture, fixtures and equipment are recorded at cost and depreciated on a straight-line basis over the estimated useful life of the asset. Projects in process represent software development costs capitalized in accordance with Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*. These projects are not yet substantially complete or ready for their intended use and therefore no depreciation has been recorded. These amounts will be reclassified to computer software upon their substantial completion and depreciated over their estimated useful life.

Accredited reviews its long-lived assets for impairment annually or when events or circumstances indicate that the carrying amount of these assets may not be recoverable. An asset is considered impaired when the expected undiscounted cash flows over the remaining useful life are less than the net book value. When impairment is indicated for an asset, the amount of impairment loss is the excess of the net book value over its fair value.

Mortgage Loan Origination Costs and Fees

Loan origination fees and certain direct origination costs are deferred as an adjustment to the carrying value of the loans. These fees and costs are recognized upon sale of loans to third-party investors or amortized over the life of the loan on a level yield basis for loans held for investment.

Interest Income

Interest income is recorded when earned. Interest income represents the interest earned on mortgage loans held for sale and on mortgage loans held for investment. For loans that are more than 90 days delinquent, Accredited reverses income previously recognized but not collected, and ceases to accrue income until all past-due amounts are collected. Interest income also includes revenue related to our mortgage loans held for investment (on-balance sheet securitizations), contractually designated as servicing income but classified as interest income for accounting purposes.

Loan Servicing and Other Fees

Fees for servicing sold loans are credited to income when received. Costs of servicing loans are expensed as incurred. Other loan fees, which include fees for the prepayment of loans, delinquent payment charges and miscellaneous loan services, are recorded as revenue when collected.

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ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Escrow and Fiduciary Funds

Accredited maintains segregated bank accounts in trust for the benefit of investors for payments on securitized loans and mortgage loans serviced for investors. Accredited also maintains bank accounts for the benefit of borrower's property tax and hazard insurance premium payments that are escrowed by borrowers. These bank accounts totaled \$155.9 million and \$147.4 million at March 31, 2007 and December 31, 2006, respectively, and are excluded from Accredited's assets and liabilities.

Income Taxes

Deferred tax assets and liabilities are determined based on temporary differences between financial reporting and tax basis of assets and liabilities and are measured by applying enacted tax rates and laws to taxable years in which such temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is established against the net deferred tax asset if realization of some or the entire deferred tax asset is questionable (realization is not more likely than not).

Real Estate Owned

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

Advertising

Accredited utilizes nondirect response advertising. As such, advertising costs are expensed as incurred.

Stock-Based Compensation

Effective January 1, 2006, Accredited adopted Financial Accounting Standards Board Statement of Financial Accounting Standards No. 123 (revised 2005), *Share-Based Payments (SFAS 123R)*, which establishes accounting standards for share-based payments issued in exchange for goods and services. SFAS 123R requires companies to measure the cost of employee services received in exchange for an award of equity instruments based on the grant date fair value of the award. That cost is recognized over the period during which an employee is to provide service in exchange for the award.

Accredited adopted the provisions of SFAS 123R, using the modified prospective application method. Under this transition method, financial statements for prior periods are not restated and compensation cost is recognized for all new awards and for the portion of prior awards for which the requisite service period was not complete as of the adoption date. Compensation cost for awards issued prior to the effective date is based on the grant-date fair value as determined under the pro forma provisions of SFAS No. 123, *Accounting for Stock-Based Compensation (SFAS 123)*. In addition, under the modified prospective method, unearned compensation is not included in Stockholders' Equity for share-based compensation plans. Rather, the awards are included in Stockholders' Equity when services required are rendered and expensed. Further information regarding share-based compensation can be found in Note 12.

Other Comprehensive Income (Loss)

Other comprehensive net income includes unrealized gains and losses that are excluded from the consolidated Statements of Operations and are reported as a separate component in stockholders' equity. The unrealized gains and losses include unrealized gains and losses on the effective portion of cash flow hedges and foreign currency translation adjustments.

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

	2007	2006
	(in thousands)	
Net income (loss)	\$ (260,168)	\$ 35,823
Net unrealized gains (losses) on cash flow hedges, net of taxes of \$0 and \$9,849, respectively	(13,885)	15,745
Reclassification adjustment into earnings for realized gain on derivatives, net of taxes of \$3,225 and \$2,741 respectively	(3,936)	(4,343)
Foreign currency translation adjustments	635	155
Total comprehensive income (loss)	\$ (277,354)	\$ 47,380

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ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Segment Reporting

Operating segments are components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. These segments should engage in business activities and have discrete financial information available, such as revenue, expenses, and assets. While Accredited's management monitors originations and sales gains by wholesale and retail channels, it does not record any of the actual financial results other than direct expenses by these groups. Accordingly, Accredited operates as one reportable operating segment.

Stock Repurchase Plan

On September 14, 2006, the Board of Directors authorized Accredited to repurchase up to 5 million shares of the Company's common stock from time to time through October 1, 2007. Under the program adopted by the Board, shares of Accredited's common stock may be repurchased from time to time in both privately negotiated and open market transactions, including pursuant to a 10b5-1 plan, subject to management's evaluation of market conditions, applicable legal requirements and other factors. A 10b5-1 plan allows Accredited to repurchase shares at times when it would ordinarily not be in the market because of its trading policies and pending developments. The repurchases may be commenced or suspended at any time without prior notice and without further announcement. During the three months ended March 31, 2007 Accredited did not repurchase any shares.

Recently Issued Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, *Accounting For Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109*, (FIN 48). FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company adopted FIN 48 beginning in fiscal year 2007 as detailed in Note 8 below. The implementation of FIN 48 did not have a material effect on the Company's results of operations, statements of condition or cash flows.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements*, (SFAS 157). SFAS 157 provides a framework for measuring fair value when such measurements are used for accounting purposes. The framework focuses on an exit price in the principal (or, alternatively, the most advantageous) market accessible in an orderly transaction between willing market participants. SFAS 157 establishes a three-tiered fair value hierarchy with Level 1 representing quoted prices for identical assets or liabilities in an active market and Level 3 representing estimated values based on unobservable inputs. Under SFAS 157, related disclosures are segregated for assets and liabilities measured at fair value based on the level used within the hierarchy to determine their fair values. The Company has not determined that it will adopt SFAS 157 on its effective date of January 1, 2008 and the financial impact, if any, upon adoption has not yet been determined.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115*, (SFAS 159). SFAS 159 permits fair value accounting to be irrevocably elected for certain financial assets and liabilities on an individual contract basis at the time of acquisition or at a remeasurement event date. Upon adoption of SFAS 159, fair value accounting may also be elected for existing financial assets and liabilities. For those instruments for which fair value accounting is elected, changes in fair value will be recognized in earnings and fees and costs associated with origination or acquisition will be recognized as incurred rather than deferred. SFAS 159 is effective January 1, 2008, with early adoption permitted as of January 1, 2007, if adopted concurrent with the adoption of SFAS 157. The Company has not determined that it will adopt SFAS 159 on January 1, 2008, and has not yet determined the financial impact, if any, upon adoption.

2. RESTRICTED CASH

Restricted cash consisted of the following deposits:

	March 31, 2007	December 31, 2006
	(in thousands)	
Reserve account in connection with asset-backed commercial paper facility (see Note 6)	\$ 83,000	\$ 65,170
Canada mortgage loan financing conduit collateral (see Note 7)	16,502	17,825
Cash in escrow on Canadian mortgage loans pending closing	4,778	4,504
Other	7,057	9,259
Total restricted cash	\$ 111,337	\$ 96,758

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ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. CONCENTRATIONS OF RISK

Significant Customers

During the three months ended March 31, 2007, Accredited sold \$ 2.7 billion and \$0.6 billion in mortgage loans to two separate investors, which represented 76% and 16%, respectively, of total mortgage loans sold. During the three months ended March 31, 2006, Accredited sold \$1.2 billion, \$0.9 billion, and \$0.4 billion in mortgage loans to three separate investors, which represented 38%, 29%, and 14%, respectively, of total mortgage loans sold. No other sales to individual investors accounted for more than 10% of total mortgage loans sold during the three months ended March 31, 2007 and 2006.

Credit Repurchase Risk

Accredited's sales of mortgage loans are subject to standard mortgage industry representations and warranties, material violations of which may require Accredited to repurchase one or more mortgage loans. Additionally, certain whole loan sale contracts include provisions requiring Accredited to repurchase a loan if a borrower fails to make one or more of the first loan payments due on the loan. During the three months ended March 31, 2007 and 2006 loans repurchased totaled \$87.3 million and \$14.6 million, respectively, pursuant to these provisions. At March 31, 2007 and December 31, 2006, the reserve for potential future repurchase losses (see Note 9) totaled \$57.9 million and \$106.1 million, respectively.

Mortgage Loan Products

The following is a description of Accredited's U.S. mortgage loan products prior to the substantial suspension of U.S. mortgage loan origination operations beginning September 2007.

Accredited offered a range of non-prime mortgage and, to a lesser degree, Alt-A mortgage loan programs, including a variety of mortgage loan programs for first and second mortgages. The key distinguishing features of each program were the documentation required, the LTV, the mortgage and consumer credit payment history, the property type and the credit score necessary to qualify under a particular program. Nevertheless, each program relied upon an analysis of each borrower's ability to repay, the risk that the borrower will not repay, the fees and rates charged, the value of the collateral, the benefit provided to the borrower, and the mortgage loan amounts relative to the risk Accredited is taking.

In general, LTV maximums decreased with credit quality and within each credit classification. Additionally, LTV maximums varied depending on the property type. For example, LTV maximums for mortgage loans secured by owner-occupied properties were higher than for mortgage loans secured by properties that were not owner-occupied. LTV maximums for Lite Documentation and Stated Income Programs were generally lower than the LTV maximums for corresponding Full Documentation programs. Accredited's maximum debt service-to-income ratios ranged from 50% to 55% for Full Documentation Programs and from 45% to 55% for Lite Documentation and Stated Income Programs.

Mortgage loans have payment schedules based upon an interest rate that is (1) constant over the life of the mortgage loan, commonly referred to as fixed-rate mortgages or FRMs, or (2) fixed for the initial six-months, two, three, five or seven years and adjusts after the initial fixed period and every six months thereafter, sometimes referred to as adjustable-rate mortgage loans or ARMs. Generally, the payments on fixed-rate mortgage loans are calculated to fully repay the mortgage loans in 15 or 30 years. In the case of balloon mortgage loans, the payments are based on a 30-year or 40 year repayment schedule, with the unpaid principal balance due in a balloon payment at the end of 15 years or 30 years. The payments on adjustable-rate mortgage loans are calculated to fully repay the mortgage loans in 30 years, with payment amount adjustments following interest rate adjustments. Fixed-rate mortgages or adjustable-rate mortgage loans may have initial interest-only periods, typically five years, during which the monthly payments are limited to the amounts required to pay accrued interest due on the mortgage loans. At the end of the interest-only periods, the monthly payments are adjusted to fully repay the mortgage loans over their remaining 25-year terms. Accredited did not offer an interest-only option in conjunction with the 40-year-due-in-30 amortization program.

Table of Contents**ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Geographical Concentration**

Properties securing the mortgage loans in Accredited's servicing portfolio (mortgage loans held for sale, mortgage loans held for investment and off-balance sheet securitizations), including mortgage loans serviced for others, are geographically dispersed throughout the United States. At March 31, 2007, and at December 31, 2006, 17% and 14% of the unpaid principal balance of mortgage loans in Accredited's servicing portfolio were secured by properties located in California and Florida, respectively. The remaining properties securing mortgage loans serviced did not exceed 10% in any other state at March 31, 2007 and December 31, 2006.

Mortgage loan originations are geographically dispersed throughout the United States and, to a much lesser extent, in Canada. During the three months ended March 31, 2007, 15% and 15% of mortgage loans originated were collateralized by properties located in California and Florida, respectively. During the three months ended March 31, 2006, 16% and 12% of mortgage loans originated were collateralized by properties located in California and Florida, respectively. The remaining originations did not exceed 10% in any other state during either of these periods.

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

4. MORTGAGE LOANS**Mortgage Loans Held for Sale**

Mortgage loans held for sale were as follows:

	March 31, 2007	December 31, 2006
	(in thousands)	
Mortgage loans held for sale (1)	\$ 431,732	\$ 2,119,509
Basis adjustment for fair value hedge accounting		2,283
Net deferred origination fees	(5,431)	(11,999)
Market valuation allowance (LOCOM)	(6,813)	(36,525)
Mortgage loans held for sale, net	\$ 419,488	\$ 2,073,268

(1) Includes \$67.1 million of Canadian loans at March 31, 2007.

Mortgage Loans Held for Investment

Mortgage loans held for investment were as follows:

	March 31, 2007	December 31, 2006
	(in thousands)	
Mortgage loans securitized	\$ 7,825,489	\$ 7,783,432
Mortgage loans held for securitization (1)		883,313

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Basis adjustment for fair value hedge accounting	(10,415)	(10,971)
Net deferred origination fees	(32,532)	(38,842)
Allowance for loan losses	(136,647)	(138,250)
Mortgage loans held for investment, net	\$ 7,645,895	\$ 8,478,682

(1) Includes \$123.4 million of Canadian loans at December 31, 2006.

Table of Contents**ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Reserves for Losses**

Activity in the reserves was as follows:

	Balance at Beginning of Period	Provision for Losses (in thousands)	Charge offs, net	Balance at End of Period
Three months Ended March 31,				
2007:				
Mortgage loans held for investment	\$ 138,250	\$ 442	\$ (2,045)	\$ 136,647
Real estate owned	40,364	24,882	(5,621)	59,625
Total	\$ 178,614	\$ 25,324	\$ (7,666)	\$ 196,272
2006:				
Mortgage loans held for investment	\$ 106,017	\$ 9,923	\$ (236)	\$ 115,704
Real estate owned	10,725	6,614	(3,637)	13,702
Total	\$ 116,742	\$ 16,537	\$ (3,873)	\$ 129,406

The following table summarizes the delinquency amounts for the serviced portfolio, including mortgage loans and real estate owned before fair value adjustment and valuation allowance, but excluding loans serviced on an interim basis (30 days or less):

	March 31, 2007 Delinquent		December 31, 2006 Delinquent	
	Principal		Principal	
	Unpaid Principal Amount (3)	Over 90 Days (in thousands)	Unpaid Principal Amount (3)	Over 90 Days
Mortgage loans held for sale(1)	\$ 431,732	\$ 12,792	\$ 2,140,523	\$ 111,636
Mortgage loans held for investment	7,858,781	330,000	8,693,995	316,252
Real estate owned	190,283	190,283	145,182	145,182
On balance sheet portfolio	8,480,796	533,075	10,979,700	573,070
Mortgage loans sold servicing retained(2)	55,204	7,640	60,428	7,844
Total serviced portfolio	\$ 8,536,000	\$ 540,715	\$ 11,040,128	\$ 580,914

(1) Includes loans repurchased.

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- (2) Includes real estate owned, not included in accompanying balance sheets.
- (3) Loans acquired from Aames were recorded at fair value at purchase. The unpaid principal balances do not include these fair value adjustments.

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Accredited uses fair value hedge accounting in accordance with SFAS No. 133 for certain derivative financial instruments used to hedge its mortgage loans held for sale. Fair value adjustments to mortgage loan carrying amounts are detailed in Note 4. Hedge ineffectiveness recorded in earnings, included as a component of gain on sale of mortgage loans in the consolidated statements of operations, is as follows (in thousands):

	Three Months Ended March 31,	
	2007	2006
Hedge ineffectiveness gains (losses)	\$ 334	\$ (479)

Cash Flow Hedges

Accredited utilizes cash flow hedge accounting on the variable rate portion of its securitization debt in accordance with the provisions of SFAS No. 133. A total of \$5.5 million in net effective gains before taxes, included in other comprehensive income at March 31, 2007, is expected to be recognized in earnings during the next twelve months.

Hedge ineffectiveness recorded in earnings, included as a component of interest expense in the consolidated statements of operations, is as follows (in thousands):

	Three Months Ended March 31,	
	2007	2006
Hedge ineffectiveness gains	\$ 4,995	\$ 446

Effective unrealized gains, net of effective unrealized losses, recorded in other comprehensive income, reported as a component of stockholders equity is as follows (in thousands):

	Three Months Ended March 31,	
	2007	2006
Net effective unrealized gains (losses)	\$ (13,885)	\$ 25,594
Related income tax expense		(9,849)
Net amount deferred to other comprehensive income	\$ (13,885)	\$ 15,745

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

3/31/2007		12/31/06	
Notional amount	Fair value	Notional amount	Fair value

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	(in thousands)			
Eurodollar futures	\$	\$	\$ 6,201,784	\$ 10,304
Options on Eurodollar futures			630,342	2,803
Interest rate swaps	5,588,112	11,246	2,363,702	490
Interest rate caps	1,113,044	1,586	880,717	7
	\$ 6,701,156	12,832	\$ 10,076,545	13,604
Margin account balances	N/A	1,932	N/A	37,841
Total		\$ 14,764		\$ 51,445

The fair value of derivative liabilities of \$9.8 million and \$31.7 million at March 31, 2007 and December 31, 2006 respectively which are included in accrued expenses and other liabilities on the consolidated balance sheet have been netted against the fair value of derivative assets shown in the table above. Notional swap amounts are not shown for securitizations in which we reverse the position of the swap embedded in the securitization trust; for these transactions the economic notional hedge amount and the net fair value of the derivatives is zero.

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The change in the fair value of derivative financial instruments and the related hedged asset or liability recorded in the consolidated statements of operations is as follows:

	Interest Income	Interest Expense	Gain on Sale (in thousands)	Total
Three Months Ended March 31, 2007:				
Net unrealized gain (loss)	\$ 1,822	\$ 20,480	\$ (8,492)	\$ 13,810
Net realized loss		(8,747)	(3,800)	(12,547)
Total	\$ 1,822	\$ 11,733	\$ (12,292)	\$ 1,263
2006:				
Net unrealized gain (loss)	\$ 673	\$ (5,946)	\$ (4,429)	\$ (9,702)
Net realized gain		13,461	8,433	21,894
Total	\$ 673	\$ 7,515	\$ 4,004	\$ 12,192

6. CREDIT FACILITIES LOANS HELD FOR SALE

Credit facilities consisted of the following:

	March 31, 2007 (in thousands)	December 31, 2006 (in thousands)
\$500 million warehouse credit facility expiring March 2008	\$	\$
\$600 million warehouse credit facility expiring March 2008	212,927	44,785
\$650 million warehouse credit facility expired July 2007	43,886	358,504
\$300 million warehouse credit facility terminated April 2007	40,701	150,051
\$600 million warehouse credit facility expired August 2007	18,843	301,462
\$171.4 million warehouse credit facility expired June 2007	33,837	96,926
\$660 million warehouse credit facility terminated March 2007		401,081
\$500 million warehouse credit facility terminated March 2007		300,035
\$500 million warehouse credit facility terminated March 2007		232,506
Other credit facility expired March 2007		20,914
\$2.5 billion asset-backed commercial paper facility terminated May 2007	80,000	879,813
Total credit facilities	\$ 430,194	\$ 2,786,077

Outstanding credit facilities at March 31, 2007 consisted of committed warehouse lines and asset-backed commercial paper. The outstanding warehouse facilities accrued interest based on one-month LIBOR (one-month bankers acceptance rate for Canada) plus a spread. The spread over LIBOR varied depending on the mortgage asset class being financed. The interest rates (One-Month LIBOR plus the spread) ranged from 5.82% to 7.82% as of March 31, 2007.

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The warehouse facilities were collateralized by mortgage loans held for sale and certain restricted cash (See Note 2).

As part of its financing strategy, Accredited maintained a \$2.5 billion asset-backed commercial paper (ABCP) facility. Under the ABCP, the funding of mortgage loan originations was financed through the issuance of (i) short- term liquidity notes (SLN) with maturities ranging from one to one hundred eighty days and (ii) subordinated notes of \$80 million. This facility was repaid and terminated in May 2007.

Our credit facilities contain extensive restrictions and covenants including minimum profitability, interest coverage, liquidity, and net worth requirements and limitations on total indebtedness. If Accredited fails to comply with any of these covenants or otherwise defaults under a facility, the lender has the right to terminate the facility and require immediate payment which may require sale of the collateral at less than optimal terms. In addition, if Accredited defaults under one facility, it would generally trigger a default under the other facilities. From January 1 to September 5, 2007, several of the covenant requirements were amended or waived to allow that Accredited remained in compliance with all requirements at period end. We anticipate requiring additional amendments to or waivers of these covenants during 2007, and there can be no assurances the lenders will so agree. In the event such amendments or waivers are required and Accredited is unable to obtain them, it could have a material and adverse impact on our ability to fund mortgage loans.

Table of Contents**ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

During the three months ended March 31, 2007, the Company sold substantially all of its loans held for sale and entered into the Farallon Loan (see Note 7) providing cash and liquidity which was used to repay many of the warehouse facilities, after which such facilities were terminated. Specifically, the Company repaid and terminated the warehouse facilities with Lehman Brothers Bank, FSB, Residential Funding Company, LLC, Goldman Sachs Mortgage Company, Merrill Lynch Bank USA, Morgan Stanley Mortgage Capital Inc. and by IXIS Real Estate Capital Inc. (formerly known as CDC Mortgage Capital Inc.).

The Company, on March 30, 2007, amended the Amended and Restated Master Repurchase Agreement, dated as of December 30, 2005, with Credit Suisse First Boston Mortgage Capital LLC (CSFB), and entered into a Master Repurchase Agreement with Wachovia Bank, N.A. (Wachovia). Under the amended agreement with CSFB, the term of the CSFB repurchase facility was extended through March 31, 2008 and the maximum committed amount able to be borrowed remained at \$600 million. Under the agreement with Wachovia (which was amended on May 1, 2007 and on July 5, 2007), the maximum amount the Company is able to borrow is \$1 billion.

On September 4, 2007, the Company entered into an amendment to the Master Repurchase Agreement with Wachovia and on September 5, 2007 entered in an amendment to the Amended and Restated Master Repurchase Agreement with CSFB, effective on and after July 31, 2007. Pursuant to these amendments, the parties modified the definition of Adjusted Tangible Net Worth to include the amount of the Company's trust preferred securities issued January 11, 2007 (see Note 7). In addition, the CSFB amendment contains an additional sublimit for performing aged warehouse loans.

Accredited anticipates that its borrowings will be repaid from net proceeds from the sale of mortgage loans and other assets, cash flows from operations, or from refinancing the borrowings.

7. SECURITIZATION AND OTHER FINANCING

Securitization and other financing consisted of the following:

	March 31, 2007 (in thousands)	December 31, 2006 (in thousands)
Securitized bond financing	\$ 7,376,712	\$ 7,281,479
Canadian mortgage loan financing conduit	335,074	345,260
Other borrowings	317,153	24,742
	8,028,939	7,651,481
Unamortized discounts	(23,657)	(8,639)
Total financing, net	\$ 8,005,282	\$ 7,642,842

Securitized Bond Financing

At March 31, 2007, securitized bond financing included securitized bonds bearing interest at fixed rates (ranging from 2.90% to 5.68%) and at variable rate indexed to one-month LIBOR plus a spread (ranging from .04% to 2.75%) maturing through 2037. The bonds were collateralized by mortgage loans held for investment with an aggregate principal balance outstanding of \$7.5 billion at March 31, 2007 and at December 31, 2006. Unamortized debt issuance costs included in prepaid expenses and other assets were \$24.4 million and \$23.1 million at March 31, 2007 and December 31, 2006, respectively.

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

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

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ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Due to the potential for prepayments of mortgage loans, the early distribution of principal to the bondholders and the optional clean-up call available under such securitizations, the bonds are not necessarily expected to be outstanding through the maturity date.

Canadian Mortgage Loan Financing Conduit

The facility bears interest at variable rates indexed to the prevailing commercial paper rate plus a spread (ranging from 0.25% to 0.85%). The notes are collateralized by Canadian residential mortgage loans originated by Accredited with an aggregate outstanding balance of \$340.7 million and \$351.0 million at March 31, 2007 and December 31, 2006, respectively, which are included in mortgage loans held for investment. In addition, \$16.5 million and \$17.8 million at March 31, 2007 and December 31, 2006, respectively, of restricted cash are pledged as collateral (see Note 2).

Other Borrowings

Accredited also maintains a \$75 million Senior Secured Credit Agreement which is scheduled to expire September 28, 2007, and is secured by mortgage servicing rights and servicing advances related to Accredited's securitizations. On March 30, 2007, the Company, as part of the Farallon Loan (described below), capped the amount that can be borrowed under this facility at \$49 million. The notes bear interest at LIBOR plus a spread of 1.5% for borrowings secured by servicing advances and 1.75% for borrowings secured by servicing rights. The balance outstanding was \$31.1 million and \$8.4 million at March 31, 2007 and December 31, 2006, respectively.

On August 30, 2007, the Company entered into an amendment to the Senior Secured Credit Agreement, effective on and after July 31, 2007. Pursuant to the amendment, the parties have modified the definition of Adjusted Tangible Net Worth to include the amount of the Company's trust preferred securities issued January 11, 2007. In addition, the amendment clarified additional terms and conditions contained in the Senior Secured Credit Agreement and capped the amount that could be borrowed under the facility at \$34 million.

On March 30, 2007, the Company and certain of its subsidiaries entered into a secured five-year term Loan Agreement with Mortgage Investment Fundings, L.L.C. ("MIF"), a lending entity managed by Farallon Capital Management (the "Farallon Loan"). Pursuant to the Loan Agreement, MIF extended term loans guaranteed by the Company in an aggregate principal amount of \$230 million (\$130 million with AHL and \$100 million with REIT). Interest accrues on the loan at 13% per annum and is payable quarterly. In conjunction with the Loan Agreement, the Company (i) issued to MIF a warrant to purchase 3,226,431 shares of common stock of the Company at an exercise price of \$10 per share and (ii) granted to MIF certain preemptive rights to purchase additional equity securities of the Company, certain registration rights with respect to its equity securities in the Company, and Board of Directors observer rights. The loans may be prepaid in full at any time, subject to payment of a premium of 7% of amounts prepaid during the first two years of the facility and a lesser premium thereafter. Upon the occurrence of a change of control, the lenders may demand prepayment of the loans and the loans shall be prepaid in full with a premium of 2% of the amount prepaid. At March 31, 2007 the balance outstanding under this agreement was \$213.9 million net of the discount which represented the fair value of the warrants at time of issuance of \$16.1 million, which is included in accrued expenses and other liabilities. The Company may be required under certain circumstances to purchase the warrants from the holders pursuant to put rights. The warrants will be adjusted to estimated fair value at each reporting period.

On January 11, 2007 Accredited issued trust preferred securities, the net proceeds of which were \$54.2 million. These unsecured securities have a 30-year term and are callable after January 30, 2012. Interest accrues at 9.01% until January 30, 2012, and at three-month LIBOR plus 3.95% thereafter. At March 31, 2007 the balance outstanding under this agreement was \$56.0 million.

Our credit facilities contain extensive restrictions and covenants including minimum profitability, interest coverage, liquidity, and net worth requirements and limitations on total indebtedness (see Note 6).

The following table summarizes the expected repayments relating to the securitization and other financing at March 31, 2007.

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	(in thousands)
Nine months ending December 31, 2007	\$ 4,047,306
Years ending December 31:	
2008	1,290,172
2009	900,372
2010	503,796
2011	318,283
2012	438,647
Thereafter	530,363
Total	\$ 8,028,939

Table of Contents**ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****8. INCOME TAXES**

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

The tax effects of significant items comprising Accredited's net deferred tax (liability) asset were as follows:

	March 31, 2007	December 31, 2006
	(in thousands)	
Deferred tax assets:		
Net operating losses	\$ 171,486	\$ 26,200
Market reserve on loans held for sale	20,922	40,457
Loan securitizations	103,017	111,348
State taxes		1,291
Other reserves and accruals	53,330	71,726
Loans held for sale	3,486	
Total deferred tax assets	352,241	251,022
Deferred tax liabilities:		
Loans held for sale		(6,858)
State taxes	(31)	
Mortgage-related securities	(8,393)	(8,239)
Cash flow hedging		(3,225)
Total deferred tax liabilities	(8,424)	(18,322)
Net deferred tax asset before valuation allowance	343,817	232,700
Valuation allowance	(223,019)	(112,140)
Net deferred tax asset after valuation allowance	\$ 120,798	\$ 120,560

The income tax provision consists of the following:

	Three Months Ended March 31, 2007	2006
	(in thousands)	
Current:		
Federal	\$ 3,153	\$ 23,886
Foreign	3,000	
State	489	6,129
Total current provision	6,642	30,015

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Deferred:

Federal	3,206	(3,697)
State	(237)	(1,601)

Total deferred provision (benefit)	2,969	(5,298)
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Total provision	\$ 9,611	\$ 24,717
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The deferred income tax (benefit) expense resulted from temporary differences in the recognition of revenues and expenses for tax and financial statement purposes. The primary sources of these differences were the origination and reversal of the following: mortgage securitizations where taxable income has been recognized in excess of book income and various reserves and accruals in which tax deductions exceed book deductions.

Table of Contents**ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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

	Three Months Ended March 31,	
	2007	2006
	(in thousands)	
Federal income tax at statutory rate	\$ (86,822)	\$ 22,062
State income tax benefit, net of federal effects	(14,975)	2,943
Federal/state valuation allowance	110,948	
REIT dividends on preferred stock	(873)	(873)
Other	1,333	585
Total provision	\$ 9,611	\$ 24,717

During the first quarter of 2007, the Company recognized tax expense of \$9.6 million against a net loss before income taxes of \$248.1 million. The tax expense was attributed to profits generated in Canada, federal and state minimum income taxes incurred despite the overall losses, and the accrual of interest relating to its liability for uncertain tax positions recorded under FIN 48. No benefit was recorded in the current period for losses generated due to the increase in the Company's valuation allowance recorded against its deferred tax assets.

As a result of losses incurred in 2007 which indicate uncertainty as to the availability of future taxable earnings, it is not likely that 100% of our accumulated deferred tax asset will be realized. As such, a valuation allowance of \$223 million has been established decreasing the total accumulated net deferred tax asset of \$343.8 million to the \$120.8 million reported in the table above. The deferred tax asset of \$120.8 million represents federal and state income taxes paid in prior years which may be recovered by future losses as a result of reversing deductible temporary differences.

The Company adopted the provisions of FIN 48 on January 1, 2007. The total liability for unrecognized tax benefits as of the date of adoption was \$9.2 million. As a result of the implementation of FIN 48, the Company recognized a \$0.1 million increase in the liability for unrecognized tax benefits, which was recorded to deferred tax assets. In addition, the Company reduced its gross deferred tax assets by \$2.7 million for unrecognized tax benefits, which was offset by a reduction in its valuation allowance by the same amount.

Included in the balance of unrecognized tax benefits at January 1, 2007, are \$11.9 million of tax benefits that, if recognized, would affect the effective tax rate. Note that of this amount, \$2.7 million of tax benefit may also be impacted by an increase in the valuation allowance, depending upon the Company's financial condition at the time the benefits are recognized.

The Company recognizes interest and penalties related to unrecognized tax benefits in provision for income taxes.

The Company is subject to taxation in the U.S., various state and foreign tax jurisdictions. The Company's tax years for 2002 and forward are subject to examination by the U.S., foreign and state tax authorities due to the existence of net operating loss carryforwards.

During the first quarter of 2007, the Company's liability for unrecognized tax benefits was increased by \$0.2 million to a balance of \$9.4 million at March 31, 2007. The increase was the result of the accrual of additional interest on the liabilities for uncertain tax positions for certain federal, foreign and state tax returns.

9. ACCRUED EXPENSES AND OTHER LIABILITIES

Accounts payable and accrued liabilities were as follows:

	March 31, 2007	December 31, 2006
	(in thousands)	
Accrued liabilities payroll	\$ 23,930	\$ 28,591
Accrued liabilities merger transaction and direct acquisition costs	20,541	23,084
Accrued liabilities general	75,405	71,769
Derivative liabilities	9,763	31,703
Reserve for repurchases and premium recapture	61,753	110,909
Total	\$ 191,392	\$ 266,056

Table of Contents**ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Activity in the reserve for repurchases and premium recapture was as follows (in thousands):

	Balance at Beginning of Period	Additions to Reserve(1)	Losses Incurred	Balance at End of Period
Three Months Ended March 31,				
2007:				
Reserve for repurchases	\$ 106,111	\$ 22,050	\$ (70,310)	\$ 57,851
Reserve for premium recapture	4,798	2,344	(3,240)	3,902
Total	\$ 110,909	\$ 24,394	\$ (73,550)	\$ 61,753
2006:				
Reserve for repurchases	\$ 7,434	\$ 1,049	\$ (441)	\$ 8,042
Reserve for premium recapture	3,317	2,105	(1,834)	3,588
Total	\$ 10,751	\$ 3,154	\$ (2,275)	\$ 11,630

(1) Reduces gain on sale of loans in the accompanying statement of operations.

10. MINORITY INTEREST IN REIT SUBSIDIARY

The minority interest in the REIT (a wholly owned subsidiary of AHL) represents Series A Preferred Shares issued to outside investors in the aggregate amount of \$102.3 million. The Series A Preferred Shares bear a dividend of 9.75% annually. The preferred shares are reported as minority interest in subsidiary in the consolidated balance sheet.

11. GAIN (LOSS) ON WHOLE LOAN SALES

The components of gain (loss) on sale of mortgage loans were as follows for the three months ended March 31, 2007 and 2006 (in thousands):

	2007	2006
Gross gain (loss) on sale of mortgage loans	\$ (147,173)	\$ 63,858
Net gain (loss) on derivatives	(12,292)	4,004
Provisions for market valuation (LOCOM), repurchases and premium recapture	(53,411)	(2,457)
Net origination points and fees	45,003	18,538
Direct mortgage loan origination expenses	(11,005)	(13,391)
 Gain (loss) on sale of mortgage loans, net	 \$ (178,878)	 \$ 70,552

12. STOCK-BASED COMPENSATION

Currently, Accredited has three types of equity instruments issued under its share-based compensation programs: stock options, restricted stock units, and restricted stock awards. Accredited discontinued its Employee Stock Purchase Plan on December 31, 2005.

Stock Option Plans

Accredited's 1995 Executive Stock Option Plan, 1995 Stock Option Plan, 1998 Stock Option Plan, and 2002 Stock Option Plan (collectively the Stock Option Plans), provide for the issuance of stock options to eligible directors, employees and consultants. Accredited's 2002 Stock Option Plan (2002 Plan) was adopted by the board of directors and approved by the stockholders in 2002. The share reserve established in the 2002 Plan consists of the number of shares remaining available for option grants and the number of options outstanding under all stock option plans.

Stock options are generally granted with an exercise price equal to the closing market price on the date of grant, have a term of 10 years and vest within four years from the date of grant. However, on February 22, 2007, 100,000 options were granted to two members of executive management with an exercise price of \$27.77 when the market value was \$23.60. The remaining 399,980 options were granted on January 31, 2007 at an exercise price of \$27.77, which was the market price at the date of grant. The fair value of each option grant is estimated on the date of grant using the Black-Scholes multiple option model. The assumptions used in the option-pricing model for options granted during the three months ended March 31, 2007 are noted in the following table:

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Weighted-average risk-free rate	4.79%
Weighted-average expected life	3.8yrs
Expected volatility	44%
Dividend yield	0%
Weighted-average grant date fair value	\$ 10.18

A summary of the change in options outstanding under Accredited's Stock Option Plans during the three months ended March 31, 2007 follows:

	Number of Options	Weighted- Average Exercise Price
	(in thousands)	
Outstanding at December 31, 2006	1,523	\$ 32.49
Options granted	500	\$ 27.77
Options exercised	(36)	\$ 6.13
Options cancelled	(249)	\$ 35.35
Outstanding at March 31, 2007	1,738	\$ 31.28

For the three months ended March 31, 2007, approximately \$1.6 million of compensation expense related to stock options was recorded.

Since the time of Accredited's initial public offering in 2003, Accredited has granted stock options, and outstanding stock options have been exercised, in reliance upon registration statements filed with the SEC on Form S-8. However, until Accredited is current on its required SEC filings under the Securities Exchange Act of 1934, as amended, Accredited cannot grant additional stock options, and outstanding stock options may not be exercised, in reliance upon such registration statements, unless an exemption from registration is available.

Deferred Compensation Plan

Accredited's Deferred Compensation Plan was adopted by the board of directors and approved by the stockholders in 2002, and became effective on January 1, 2003. The plan is an unfunded, nonqualified deferred compensation plan that benefits directors, certain designated key members of management and key employees. Under the plan, participants may defer up to 100% of their base salary, director fee, bonus and/or commissions on a pre-tax basis. The Deferred Compensation Plan permits the granting of restricted stock units (RSUs) to eligible participants. The RSUs generally vest 50% two years from the date of grant and 25% each year thereafter until fully vested and are payable in the Company's common stock upon distribution. RSUs granted to directors vest after 2 years. The fair value of restricted stock is based upon the market price of the underlying common stock at the date of grant. The per share weighted-average grant date fair value of units granted during the three months ended March 31, 2007 and 2006 was \$27.39, and \$52.20, respectively.

A summary of the change in RSUs outstanding under Accredited's Deferred Compensation Plan during the three months ended March 31, 2007 follows:

	Units (in thousands)
Outstanding at December 31, 2006	655
Granted	91
Released	(38)
Forfeited	(24)

Outstanding at March 31, 2007

684

Units vested not converted

237

For the three months ended March 31, 2007, approximately \$1.7 million of compensation expense related to restricted stock units was recorded.

Table of Contents**ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Grants of RSU's under the Deferred Compensation Plan have been made in reliance upon registration statements filed with the SEC on Form S-8. However, until Accredited is current on its required SEC filings under the Securities Exchange Act of 1934, as amended, Accredited cannot grant additional RSU's in reliance upon such registration statements, unless an exemption from registration is available.

Restricted Stock Awards

Accredited issued 41,000 shares of restricted stock shares to two of its officers in 2005 as an inducement to employment. The expense for these shares is recognized over the awards' five-year vesting period. A summary of the change in the restricted stock awards during the three months ended March 31, 2007 follows:

	Awards (in thousands)
Outstanding at December 31, 2006	36
Granted	
Released	(3)
Forfeited	
Outstanding at March 31, 2007	33

For the three months ended March 31, 2007, approximately \$0.1 million of compensation expense related to restricted stock units was recorded.

These grants were made in reliance upon registration statements filed with the SEC on Form S-8. However, until Accredited is current on its required SEC filings under the Securities Exchange Act of 1934, as amended, Accredited cannot grant additional restricted stock awards in reliance upon such registration statements, unless an exemption from registration is available.

13. EARNINGS (LOSS) PER SHARE

Basic earnings per share is computed by dividing net income (loss) by the weighted average number of common shares outstanding and the weighted average number of vested, restricted common stock units for the period. Diluted earnings per share reflects the potential dilution that could occur if net income were divided by the weighted average number of common shares and unvested, restricted common stock units, plus potential common shares from outstanding stock options and unvested restricted stock units where the effect of those securities is dilutive.

The computations for basic and diluted earnings (loss) per share are as follows:

	Net Income (loss) (numerator) (in thousands, except per share amounts)	Shares (denominator)	Per Share Amount
Three Months Ended March 31, 2007:			
Basic earnings (loss) per share	\$ (260,168)	25,282	\$ (10.29)
Effect of dilutive shares:			
Stock options			
Restricted stock units			

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Warrants

Diluted earnings per share	\$ (260,168)	25,282	\$ (10.29)
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Potentially dilutive shares not included above since they are antidilutive	1,911
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2006:

Basic earnings per share	\$ 35,823	21,553	\$ 1.66
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Effect of dilutive shares:

Stock options	497
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Restricted stock units	229
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Diluted earnings per share	\$ 35,823	22,279	\$ 1.61
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Potentially dilutive shares not included above since they are antidilutive	367
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ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

14. COMMITMENTS AND CONTINGENCIES

In the normal course of business to meet the financing needs of its borrowers, Accredited is party to financial instruments with off-balance sheet risk. These financial instruments primarily represent commitments to fund loans. These instruments involve, to varying degrees, elements of interest rate risk and credit risk in excess of the amount recognized in the balance sheet. The credit risk is mitigated by Accredited's evaluation of the creditworthiness of potential mortgage loan borrowers on a case-by-case basis. Accredited does not guarantee interest rates to potential borrowers when an application is received. Interest rates conditionally approved following the initial underwriting of applications are subject to adjustment if any conditions are not satisfied. Accredited commits to originate loans, in many cases dependent on the borrower's satisfying various terms and conditions. These commitments totaled \$473 million as of March 31, 2007.

Commitments to sell loans generally have fixed expiration dates or other termination clauses and may require payment of a commitment or a non-delivery fee.

Accredited periodically enters into other loan sale commitments. At March 31, 2007 forward loan sale commitments awaiting settlement amounted to \$400 million.

Accredited's mortgage banking business is subject to the rules and regulations of the Department of Housing and Urban Development (HUD). Those rules and regulations require, among other things, that Accredited maintain a minimum net worth of \$250,000. Accredited is in compliance with these requirements.

From time to time, Accredited enters into certain types of contracts that contingently require Accredited to indemnify parties against third party claims and other obligations customarily indemnified in the ordinary course of Accredited's business. The terms of such obligations vary and, generally, a maximum obligation is not explicitly stated. Therefore, the overall maximum amount of these obligations cannot be reasonably estimated. Historically, Accredited has not been obligated to make significant payments for these obligations and no liabilities have been recorded for these obligations on its balance sheet as of March 31, 2007.

Accredited irrevocably and unconditionally agrees to pay in full to the holders of each share of the REIT's Series A Preferred Shares: (i) all accrued and unpaid dividends, (ii) the redemption price and (iii) the liquidation preference. See further discussion under Note 11. Minority Interest in REIT Subsidiary.

Legal Matters

In September 2007, AHL was named in a class action complaint, *Hayes v. Accredited Home Lenders Holding, Co. and Accredited Home Lenders, Inc.* brought in the United States District Court for the Southern District of California. The complaint alleges that AHL violated the Worker Adjustment and Retraining Notification (WARN) Act by failing to provide 60 days' notice to plaintiffs who were terminated through no fault of their own as part of or as the reasonable consequence of a mass layoff and/or plant closing effectuated by AHL on or about August 22, 2007. The plaintiffs seek to recover, on behalf of themselves and other similarly situated former employees, the alleged wages for the work days in the 60 calendar days prior to their respective terminations along with benefits, interest, attorneys' fees and costs of suit. AHL has not been served with the action, a motion to certify a class has not been filed, and there has been no ruling on the merits of either the plaintiffs' individual claims or the claims of the putative class. AHL intends to vigorously defend this matter, but the ultimate outcome of this matter and the amount of liability, if any, which may result is not presently determinable.

In August 2007, AHLHC and AHL were served with a class action complaint, *Taylor v. Accredited Home Lenders Holding, Co. and Accredited Home Lenders, Inc.* brought in the United States District Court for the Southern District of California. The complaint alleges AHLHC and AHL violated the Equal Credit Opportunity Act and Fair Housing Act by charging, through the use of a discretionary pricing policy, a higher Annual Percentage Rate (APR) to African-American borrowers than the APR charged to similarly situated Caucasian borrowers. The plaintiff seeks to recover, on behalf of herself and other similarly situated African-American borrowers, compensatory and punitive damages, declaratory and injunctive relief, and recovery of attorneys' fees and costs of suit. Neither AHLHC nor AHL have been served with the action, a motion to certify a class has not been filed, and there has been no ruling on the merits of either the plaintiffs' individual claims or the claims of the putative class. AHLHC and AHL intend to vigorously defend this matter, but the ultimate outcome of this matter and the amount of liability, if any, which may

result is not presently determinable.

In August 2007, AHL was served with a class action complaint, *Viera et al. v. Accredited Home Lenders Holding, Inc.[sic]*, brought in the United States District Court for the Western District of Texas. The complaint alleges that AHL

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ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

violated the WARN Act by failing to provide 60 days' notice to plaintiffs who were terminated through no fault of their own as part of or as the reasonable consequence of a mass layoff and/or plant closing effectuated by AHL on or about August 10 and 22, 2007. The plaintiffs seek to recover, on behalf of themselves and other similarly situated former employees, the alleged wages for the work days in the 60 calendar days prior to their respective terminations along with benefits, interest, attorneys' fees and costs of suit. A motion to certify a class has not yet been filed, and there has been no ruling on the merits of either the plaintiffs' individual claims or the claims of the putative class. AHL intends to vigorously defend this matter, but the ultimate outcome of this matter and the amount of liability, if any, which may result is not presently determinable.

In August 2007, AHLHC filed a complaint, *Accredited Home Lenders Holding Co. v. Lone Star Fund V (U.S.), L.P., et al.*, in the Court of Chancery of the State of Delaware for New Castle County. The complaint alleges that Lone Star Fund V (U.S.), L.P. ("Lone Star") and two of its affiliates breached contractual obligations to, among other things, close the tender offer for AHLHC's common stock pending under the Agreement and Plan of Merger entered into among such affiliates and AHLHC (the "Merger Agreement"). AHLHC seeks specific performance of the contractual obligations or, in the alternative, damages for breach of contract. The ultimate outcome of this matter is not presently determinable, but, if determined adversely to AHLHC, the outcome could have a material adverse effect on the business of AHLHC and its subsidiaries.

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

In July 2007, AHL was named in a class action complaint, *National Association for the Advancement of Colored People (NAACP) v. Ameriquest Mortgage Company, et al.*, brought in the United States District Court for the Central District of California. The NAACP filed the action on behalf of itself and its African-American members, alleging that AHL and 12 other lenders violated the Fair Housing Act, Equal Credit Opportunity Act, and Civil Rights Act by steering African-American applicants who would otherwise qualify for prime loans into non-prime loans and charging African-American borrowers higher interest rates and fees than similarly situated Caucasians. Plaintiff seeks, on behalf of itself and others similarly situated, declaratory and injunctive relief and recovery of attorneys' fees and costs of suit. AHL has not been served with the complaint and is unaware of any motion to certify the class having been filed or of any ruling on the merits of either the plaintiff's individual claims or those of the putative class. The ultimate outcome of this matter and the amount of liability, if any, which may result is not presently determinable, but AHL does not believe it will have a material adverse effect on its business.

In June 2007, AHLHC was served with two class action complaints, *Korsinski v. Accredited Home Lenders Holding Co., et al.* and *Wan v. Accredited Home Lenders Holding Co., et al.*, brought in the Superior Court of the State of California, County of San Diego. The complaints allege breaches of fiduciary duty by AHLHC and members of its Board of Directors in connection with AHLHC's entry into the Merger Agreement with affiliates of Lone Star. Plaintiffs seek to enjoin the tender offer for AHLHC common stock which is pending under the Merger Agreement, and recovery of attorneys' fees and costs of suit. The *Korsinski* matter has been voluntarily dismissed by the plaintiff without prejudice. In the *Wan* matter, parties have entered into a Memorandum of Understanding for settlement of the case, subject to certain conditions, including most significantly the completion of the tender offer at the offer price of \$15.10 per share. If the settlement is not consummated because the tender offer is not completed, the impact on the future of this matter is uncertain, but the Company does not believe this matter will have a material adverse effect on the Company's business.

In March 2007, AHLHC was served with a class action complaint, *Atlas v. Accredited Home Lenders Holding Co., et al.*, brought in the United States District Court for the Southern District of California. The complaint alleges violations of federal securities laws by AHLHC and certain members of senior management. AHLHC is aware that five similar securities class actions, *Joory v. Accredited Home Lenders Holding Co., et al.*, *Pourshafie v. Accredited Home Lenders Holding Co., et al.*, *Theda v. Accredited Home Lenders Holding Co., et al.*, *City of Brockton Retirement System v. Accredited Home Lenders Holding Co.*, and *Kornfeld v. James A. Konrath, et al.*, have been filed in the same court. Pursuant to the Private Securities Litigation Reform Act, these cases have been consolidated and a lead plaintiff has been selected. The

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consolidated, amended complaint was filed on August 24, 2007, and added as defendants the REIT and certain directors of AHLHC. AHLHC's response to this complaint is currently scheduled to be due October 8, 2007. The Company intends to continue to vigorously defend this matter. The ultimate outcome of this matter and the amount of liability, if any, which may result, is not presently determinable, but the Company does not believe this action will have a material adverse effect on its business.

Table of Contents**ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

In March 2007, AHL was served with a class action complaint, *Edwards v. Accredited Home Lenders, Inc., et al.*, brought in the United States District Court for the Southern District of Alabama. The complaint alleges violations of the federal Truth in Lending Act for allegedly failing to disclose title insurance charges and recording fees as part of finance charges. A motion to certify a class has not yet been filed, there has been no ruling on the merits of either the plaintiff's individual claims or the claims of the putative class, and AHL intends to continue to vigorously defend this action. The ultimate outcome of this matter and the amount of liability, if any, which may result is not presently determinable, but the Company does not believe it will have a material adverse effect on its business.

In February 2007, AHL acknowledged service of a class action complaint, *Sierra v. Aames Home Loan*, brought in the Superior Court for Los Angeles County, California. As a result of the mergers between AHLHC and Aames Investment Corporation (AIC) and between certain of their respective subsidiaries, AHL has succeeded to the litigation interests of AIC and its subsidiaries, including the interest under this matter of Aames Home Loan (a trade name of Aames Funding Corporation (AFC)) in this lawsuit. The named plaintiff is a former commissioned loan officer of AFC, and the complaint alleges that AFC violated state law by requiring the plaintiff to work overtime without compensation. The plaintiff seeks to recover, on behalf of himself and other similarly situated employees, the allegedly unpaid overtime, general damages, multiple statutory penalties and interest, attorneys' fees and costs of suit. A motion to certify a class has not yet been filed, there has been no ruling on the merits of either the plaintiffs' individual claims or the claims of the putative class, and AHL intends to continue to vigorously defend this matter. The ultimate outcome of this matter and the amount of liability, if any, which may result is not presently determinable, but the Company does not believe it will have a material adverse effect on its business.

In October 2006, as a result of the mergers referenced above, AHL succeeded to the position of AFC under a class action complaint, *Miller v. Aames Funding Corporation*, filed in the United States District Court, Eastern District of Texas. The complaint alleges that adjustable-rate home equity loans originated by AFC in Texas violate the Texas Constitution's requirement that such loans be scheduled to be repaid in substantially equal installments. The plaintiffs seek to recover, on behalf of themselves and similarly situated individuals, damages, declaratory and injunctive relief, attorneys' fees, and any other relief the court may grant. On September 29, 2006, the court on its own motion stayed the action, pending the resolution of class certification issues in a similar action pending before the court. A motion to certify a class has not yet been filed, there has been no ruling on the merits of either the plaintiff's individual claims or the claims of the putative class, and AHL intends to continue to vigorously defend this matter. The ultimate outcome of this matter and the amount of liability, if any, which may result is not presently determinable. If, however, a class were to be certified and were to prevail on the merits, the potential liability could have a material adverse effect on the Company's business.

In October 2006, by virtue of the mergers referenced above, AHLHC and AHL succeeded to the interests of AIC and AFC under the matters of *Webb, et al., v. Aames Investment Corporation, et al.* (U.S. District Court, Central District of California) and *Cooper, et al., v. Aames Funding Corporation* (U.S. District Court, Eastern District of Wisconsin), class action complaints which allege violations of the Fair Credit Reporting Act in connection with prescreened offers of credit and are similar in nature to the *Phillips* matter referenced below. The *Cooper* matter was transferred to the Central District of California and consolidated with the *Webb* matter by stipulation of counsel on September 29, 2006. A hearing on the motion to certify a class is currently scheduled for October 1, 2007. There has been no ruling on the merits of either the plaintiffs' individual claims or the claims of the putative class, and AHLHC and each affected subsidiary intend to continue to vigorously defend this matter. The ultimate outcome of this matter and the amount of liability, if any, which may result is not presently determinable. If, however, a class were to be certified and were to prevail on the merits, the potential liability could have a material adverse effect on the Company's business.

In March 2006, AHL was served with a class action complaint, *Cabrejas v. Accredited Home Lenders, Inc.*, brought in the Circuit Court for Prince George's County, Maryland. The complaint alleges that AHL's origination of second lien loans in Maryland violated the Maryland Secondary Mortgage Loan Law (the SMLL) and Consumer Protection Act in that fees charged on such loans exceeded 10% of the respective loan amounts. The plaintiffs seek to recover, on behalf of themselves and similarly situated individuals, damages, disgorgement of fees, pre-judgment interest, declaratory and injunctive relief, attorneys' fees, and any other relief the court may grant. On April 13, 2006, AHL removed the action to the United States District Court, District of Maryland. On May 15, 2006, AHL filed a motion to dismiss plaintiffs' second cause of action alleging a violation of the Maryland Consumer Protection Act on the basis that full disclosure of the fees cannot be an unfair or deceptive trade practice, which motion was granted on December 4, 2006. On January 3, 2007, plaintiffs filed a Second Amended Complaint, alleging that AHL's origination in Maryland of second lien loans with balloon payments was also a violation of the SMLL. On July 5, 2007, the court granted AHL's motion to dismiss this new claim on the basis that the SMLL's prohibition of balloon payments was and is preempted by the federal Alternative Mortgage Transactions Parity Act. A motion to certify a class has not yet been filed, there has been no ruling on the merits of either the plaintiff's remaining individual claims or the remaining claims of the putative class, and AHL intends to continue to vigorously defend

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this matter. The ultimate outcome of this matter and the amount of liability, if any, which may result is not presently determinable, but the Company does not believe it will have a material adverse effect on its business.

Table of Contents**ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

In September 2005, AHL and AHLHC were served with a class action complaint, *Phillips v. Accredited Home Lenders Holding Company, et al.*, brought in the United States District Court, Central District of California. The complaint alleges violations of the Fair Credit Reporting Act in connection with prescreened offers of credit made by AHL. The plaintiff seeks to recover, on behalf of the named plaintiff and similarly situated individuals, damages, pre-judgment interest, declaratory and injunctive relief, attorneys' fees, and any other relief the court may grant. On January 4, 2006, the plaintiff re-filed the action in response to the court's December 9, 2005, decision granting AHL's and AHLHC's motion to (1) dismiss with prejudice plaintiff's claim that AHL's offer of credit failed to include the clear and conspicuous disclosures required by FCRA, (2) strike plaintiff's request for declaratory and injunctive relief, and (3) sever plaintiff's claims as to AHL and AHLHC from those made against other defendants unaffiliated with AHL or AHLHC. Plaintiff's remaining claim is that AHL's offer of credit did not meet FCRA's firm offer requirement. On May 15, 2007, the court granted plaintiff's motion to certify two subclasses, the first consisting of 58,750 recipients of the initial mailer received by the named plaintiff, and a second consisting of 70,585 recipients of the second mailer received by the named plaintiff. On May 24, 2007, AHL and AHLHC filed a Petition for Leave to Appeal with the Ninth Circuit Court of Appeals, seeking an immediate appeal from the Order granting class certification and a stay of the action in the District Court pending the outcome of that appeal. A ruling on this appeal is not expected until the third quarter of 2007. In the meantime, there has been no ruling on the merits of either the plaintiff's individual claims or the claims of the putative class, and AHL and AHLHC intend to continue to vigorously defend this matter. The ultimate outcome of this matter and the amount of liability, if any, which may result is not presently determinable. If, however, the class certification stands and either or both subclasses were to prevail on the merits, the potential liability could have a material adverse effect on the Company's business.

In January 2004, AHL was served with a complaint, *Yturalde v. Accredited Home Lenders, Inc.*, brought in Sacramento County, California. The named plaintiff is a former commissioned loan officer of AHL, and the complaint alleges that AHL violated California and federal law by misclassifying the plaintiff and other non-exempt employees as exempt employees, failing to pay the plaintiff on an hourly basis and for overtime worked, and failing to properly and accurately record and maintain payroll information. The plaintiff seeks to recover, on behalf of himself and all of our other similarly situated current and former employees, lost wages and benefits, general damages, multiple statutory penalties and interest, attorneys' fees and costs of suit, and also seeks to enjoin further violations of wage and overtime laws and retaliation against employees who complain about such violations. AHL has been served with eleven substantially similar complaints on behalf of certain other former and current employees, which have been consolidated with the Yturalde action. The parties have agreed to, and the court has approved, a settlement with respect to the named plaintiffs and with respect to a class of current and former AHL employees which the court has certified for settlement purposes. The amount payable by the Company under the settlement is not material to its financial condition or results of operations.

In December 2002, AHL was served with a complaint and motion for class certification in a class action lawsuit, *Wratchford et al. v. Accredited Home Lenders, Inc.*, brought in Madison County, Illinois under the Illinois Consumer Fraud and Deceptive Business Practices Act, the consumer protection statutes of the other states in which AHL does business and the common law of unjust enrichment. The complaint alleges that AHL has a practice of misrepresenting and inflating the amount of fees it pays to third parties in connection with the residential mortgage loans that it funds. The plaintiffs claim to represent a nationwide class consisting of others similarly situated, that is, those who paid AHL to pay, or reimburse AHL's payments of, third-party fees in connection with residential mortgage loans and never received a refund for the difference between what they paid and what was actually paid to the third party. The plaintiffs are seeking to recover damages on behalf of themselves and the class, in addition to pre-judgment interest, post-judgment interest, and any other relief the court may grant. On January 28, 2005, the court issued an order conditionally certifying (1) a class of Illinois residents with respect to the alleged violation of the Illinois Consumer Fraud and Deceptive Business Practices Act who, since November 19, 1997, paid money to AHL for third-party fees in connection with residential mortgage loans and never received a refund of the difference between the amount they paid to AHL and the amount AHL paid to the third party and (2) a nationwide class of claimants with respect to an unjust enrichment cause of action included in the original complaint who, since November 19, 1997 paid money to AHL for third-party fees in connection with residential mortgage loans and never received a refund of the difference between the amount they paid AHL and the amount AHL paid the third party. There has not yet been a ruling on the merits of either the plaintiffs' individual claims or the claims of the class, and AHL intends to continue to vigorously defend this matter. The ultimate outcome of this matter and the amount of liability, if any, that may result is not presently determinable, but the Company does not believe it will have a material adverse effect on its business.

Accredited has accrued for loss contingencies with respect to the foregoing matters to the extent it is probable that a liability has been occurred at the date of the consolidated financial statements and the amount of the loss can be reasonably estimated. Management does not deem the amount of such accrual to be material.

Table of Contents**ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

In addition, because the nature of Accredited's business involves the collection of numerous accounts, the validity of liens and compliance with various state and federal lending laws, Accredited is subject to various legal proceedings in the ordinary course of business related to foreclosures, bankruptcies, condemnation and quiet title actions, and alleged statutory and regulatory violations. Accredited is also subject to legal proceedings in the ordinary course of business related to employment matters. Accredited does not believe that the resolution of these lawsuits will have a material adverse effect on its financial condition or results of operations.

15. SUPPLEMENTAL CASH FLOW INFORMATION

The following represents supplemental cash flow information:

	Three Months Ended March 31,	
	2007	2006
	(in thousands)	
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	\$ 147,366	\$ 81,945
Income taxes	\$ (26,234)	\$ 83,312
SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Transfer of mortgage loans held for sale to mortgage loans held for investment	\$	\$ 911,885
Transfer of mortgage loans held for sale to real estate owned, net of reserve	\$ 26,575	\$ 6,007
Transfer of mortgage loans held for investment to real estate owned, net of reserve	\$ 39,302	\$ 6,725

16. SUBSEQUENT EVENTS

On March 15, 2007, we received a notice from the staff of NASDAQ stating that our common stock may be subject to delisting because we had not filed with the Securities and Exchange Commissions (the "SEC") our Annual Report on Form 10-K ("10-K") for the year ended December 31, 2006 on a timely basis. We requested a hearing before the NASDAQ Listing Qualifications Panel (the "Panel") to appeal the NASDAQ staff's determination and to present our plan to regain compliance with NASDAQ's filing requirements. The hearing request automatically stayed the delisting of the common stock pending the Panel's review and decision. In addition, on May 15, 2007 and on August 14, 2007, we received additional deficiency notices from the staff of NASDAQ stating that the failure to timely file with the SEC our Quarterly Report on Form 10-Q ("10-Q") for the quarters ended March 31, 2007 and June 30, 2007, respectively, could serve as additional bases for the delisting of our common stock.

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

In addition, for continued listing of our common stock on NASDAQ, we are required to, among other things, maintain certain minimum thresholds with regard to stockholders' equity and minimum closing bid prices. If we do not meet the continued listing requirements, our common stock could be subject to delisting from trading on NASDAQ. There can be no assurance that we will continue to meet all requirements for continued listing on NASDAQ.

If we are unable to continue to list our common stock for trading on NASDAQ, there may be an adverse impact on the market price and liquidity of our common stock, and our stock may be subject to the "penny stock rules" contained in Section 15(g) of the Securities Exchange Act of 1934, as amended, and the rules promulgated there under. Delisting of our common stock from NASDAQ could also materially adversely affect our business, including, among other things: our ability to raise additional financing to fund our operations; our ability to attract and retain customers; and our ability to attract and retain personnel, including management personnel. In addition, if our common stock were no longer

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listed for trading on NASDAQ, many institutional investors would no longer be able to retain their interests in and/or make further investments in our common stock because of their internal rules and protocols.

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

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ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

On June 4, 2007 Accredited and affiliates of Lone Star Fund V (U.S.) L.P. (Lone Star), entered into a definitive merger agreement pursuant to which Lone Star agreed to acquire all of the common stock of Accredited in an all-cash transaction. Under the terms of the agreement, Lone Star agreed to acquire each outstanding share of Accredited common stock at a price of \$15.10 per share, for a total consideration of approximately \$400 million. The acquisition is structured as an all-cash tender offer for all outstanding shares of Accredited common stock to be followed by a merger in which each remaining untendered share of Accredited will be converted into the same \$15.10 cash per share price paid in the tender offer. The outstanding 9.75% Series A Preferred Shares, par value \$1.00 per share (the Series A Preferred), of Accredited Mortgage Loan REIT Trust would be expected to remain outstanding following the consummation of the acquisition.

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

On August 17, 2007 we entered into a transaction treated as a financing for accounting purposes. The transaction includes a call provision exercisable by Accredited which results in the transaction failing to qualify for sale treatment in accordance with certain provisions of SFAS 140. The Company has agreed to trade approximately \$1 billion of loans at an advance rate comparable to the advance rates the Company was then receiving from warehouse lenders. The initial settlement consisted of a pool of approximately \$500 million mortgage loans and closed on August 17, 2007. The remaining loans are scheduled to trade every other week as borrowers make their first payments due under the subject loans. The final settlement of loans is expected to occur by October 2007. Under the agreement, Accredited has the right but not the obligation, in our sole discretion, to reacquire all of the loans traded through mid-November 2007 at a premium to the advance rate. If we do not reacquire the loans by mid-November, our right to reacquire the loans expires and the investor will keep the loans with limited recourse to the Company and the Company would then recognize the transaction as a sale.

Beginning in September 2007, we implemented a restructuring that includes the closing of all retail lending operations, a significant downsizing of wholesale lending operations, and substantial suspension of all U.S. lending unless and until the return of market conditions under which non-prime mortgage loans can again be originated and sold or securitized at a profit. These actions resulted in the closing of 60 retail branch locations, five centralized retail support locations, five wholesale divisions and the settlement services division, and reduced the workforce by approximately 1,600 employees to approximately 1,000 at September 14, 2007.

Table of Contents**ACCREDITED MORTGAGE LOAN REIT TRUST****BALANCE SHEETS**

(in thousands, except per share data)

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

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

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

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

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

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

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

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

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ACCREDITED MORTGAGE LOAN REIT TRUST

NOTES TO UNAUDITED FINANCIAL STATEMENTS

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

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

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

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

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

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

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

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

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

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ACCREDITED MORTGAGE LOAN REIT TRUST

NOTES TO UNAUDITED FINANCIAL STATEMENTS (Continued)

Use of Estimates

The preparation of financial statements, in conformity with accounting principles generally accepted in the United States of America, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates and assumptions included in our consolidated financial statements relate to the provision for loan losses, hedging policies and income taxes.

Cash and Cash Equivalents

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

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

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

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

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

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

After the mortgage loans are designated as held for securitization, the REIT estimates the losses inherent in the portfolio at the balance sheet date and establishes an allowance for mortgage loan losses. The provision for mortgage loan losses on mortgage loans held for securitization is made in an amount sufficient to maintain credit loss allowances at a level considered appropriate to cover probable losses in the portfolio. The REIT defines a mortgage loan as non-accruing at the time the mortgage loan becomes 90 days or more delinquent under its payment terms. Probable losses are determined based on segmenting mortgage loans in the portfolio according to their contractual delinquency status and applying the REIT and AHL's expected loss experience. A number of other analytical tools are used to determine the reasonableness of the allowance for

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mortgage loan losses. Loss estimates are reviewed periodically and adjustments, if any, are reported in earnings. As these estimates are influenced by factors outside of the REIT's control, there is uncertainty inherent in these estimates, making it reasonably possible that they could change. Mortgage loans foreclosed upon or deemed uncollectible are carried at lower of cost or fair value less disposition costs.

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ACCREDITED MORTGAGE LOAN REIT TRUST

NOTES TO UNAUDITED FINANCIAL STATEMENTS (Continued)

Derivative Financial Instruments

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

Cash Flow Hedges

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

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

Mortgage Loan Origination Costs and Fees

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

Interest Income

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

Income Taxes

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

Real Estate Owned

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

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

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

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

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

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

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

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

3. MORTGAGE LOANS HELD FOR INVESTMENT

Mortgage loans held for investment were as follows:

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

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Allowance for losses Activity in the allowance was as follows:

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

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

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

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

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

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

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

Cash Flow Hedges

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

	Three Months Ended March 31,	
	2007	2006
Hedge ineffectiveness recorded in earnings, included as a component of interest expense in the consolidated statements of operations as of March 31:	\$ 5,277	\$ 522
Effective unrealized gains, net of effective unrealized losses, recorded in other comprehensive income, reported as a component of stockholders' equity as of March 31:	\$ (14,526)	\$ 24,746

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

	March 31, 2007		December 31, 2006	
	Notional amount	Fair value (in thousands)	Notional amount	Fair value
Eurodollar futures	\$	\$	\$ 3,758,974	\$ 4,970
Options on Eurodollar futures			630,342	2,803

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

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

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

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

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

5. CREDIT FACILITIES

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

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

6. SECURITIZATION AND OTHER FINANCING

Securitization bond financing consisted of the following:

	March 31, 2007	December 31, 2006
	(in thousands)	
Securitized Bond Financing	\$ 7,376,711	\$ 7,281,480
Other borrowings	100,004	16,368
	7,476,715	7,297,848
Unamortized bond discounts	(13,171)	(8,639)

Total financing, net	\$ 7,463,544	\$ 7,289,209
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ACCREDITED MORTGAGE LOAN REIT TRUST

NOTES TO UNAUDITED FINANCIAL STATEMENTS (Continued)

Securitized Bond Financing:

At March 31, 2007 securitized bond financing includes securitized bonds bearing interest at fixed rates (ranging from 2.90% to 5.68%) and at variable rates indexed to one-month LIBOR plus a spread (ranging from .04% to 2.75%) maturing through 2037. The bonds are collateralized by mortgage loans held for investment with an aggregate principal balance outstanding of \$7.5 billion at March 31, 2007 and at December 31, 2006. Unamortized debt issuance costs included in prepaid expenses and other assets were \$24.4 million and \$23.1 million at March 31, 2007 and December 31, 2006, respectively.

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

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

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

Other Borrowings:

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

Our credit facilities contain extensive restrictions and covenants including minimum profitability, interest coverage, liquidity, and net worth requirements and limitations on total indebtedness. If Accredited fails to comply with any of these covenants or otherwise defaults under a facility, the lender has the right to terminate the facility and require immediate payment which may require sale of the collateral at less than optimal terms. In addition, if Accredited defaults under one facility, it would generally trigger a default under the other facilities. From January 1 to September 5, 2007, several of the covenant requirements were amended or waived to allow Accredited to remain in compliance with all requirements. We anticipate requiring additional amendments to or waivers of these covenants during 2007, and there can be no assurance the lenders will so agree. In the event such amendments or waivers are required and Accredited is unable to obtain them, it could have a material and adverse impact on our ability to fund mortgage loans and continue as a going concern.

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

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

	(in thousands)
Nine months ending December 31, 2007	\$ 3,975,358
Year ending December 31:	
2008	1,170,377
2009	761,320
2010	474,996
2011	311,662
2012	308,639
Thereafter	474,363
Total	\$ 7,476,715

7. INCOME TAXES AND DISTRIBUTION OF EARNINGS

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

The RE