

ACCREDITED HOME LENDERS HOLDING CO
Form 10-Q
October 19, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 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)

15253 Avenue of Science
San Diego, California 92128

04-3669482
(I.R.S. Employer
Identification No.)

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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 October 11, 2007 was 25,154,093.

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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. This report includes 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:

the impact of our recent merger with an affiliate of Lone Star Fund V (U.S.), L.P.;

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;

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 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

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.

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)

	June 30, 2007 (Unaudited)	December 31, 2006
ASSETS		
Cash and cash equivalents	\$ 237,176	\$ 173,113
Restricted cash	42,166	96,758
Accrued interest receivable	49,337	68,128
Mortgage loans held for sale, net	971,592	2,073,268
Mortgage loans held for investment, net of allowance of \$144,160 and \$138,250, respectively	6,991,565	8,478,682
Derivative assets, including margin account	43,399	83,148
Deferred income tax asset, net	118,535	120,560
Real estate owned, net	174,811	104,818
Prepaid expenses and other assets	123,498	103,270
Furniture, fixtures and equipment, net	42,622	47,301
Total assets	\$ 8,794,701	\$ 11,349,046
LIABILITIES AND STOCKHOLDERS EQUITY		
LIABILITIES:		
Credit facilities-mortgage loans held for sale	\$ 878,313	\$ 2,786,077
Securitization and other financing	7,410,736	7,642,842
Income taxes payable, current	13,114	
Accrued expenses and other liabilities	169,057	266,056
Total liabilities	8,471,220	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 25,124,190 shares and 25,026,234 shares, respectively	25	25
Additional paid-in capital	318,251	311,683
Accumulated other comprehensive income	6,285	6,388
Retained earnings (accumulated deficit)	(99,002)	238,053
Total stockholders equity	225,559	556,149
Total liabilities and stockholders equity	\$ 8,794,701	\$ 11,349,046

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

ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts) (Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
REVENUES:				
Interest income	\$ 158,099	\$ 205,050	\$ 353,359	\$ 399,507
Interest expense	(116,990)	(126,976)	(253,866)	(239,111)
Net interest income	41,109	78,074	99,493	160,396
Provision for losses on mortgage loans held for investment	(32,146)	(13,062)	(57,470)	(29,599)
Net interest income after provision	8,963	65,012	42,023	130,797
Gain (loss) on sale of mortgage loans, net	(1,557)	80,673	(180,435)	151,226
Mortgage loan servicing income	4,819	4,032	7,727	7,439
Other income	7,476	3,450	15,821	5,400
Total net revenues	19,701	153,167	(114,864)	294,862
OPERATING EXPENSES:				
Salaries, wages and benefits	49,452	49,274	114,064	96,800
General and administrative expenses	19,869	15,539	40,996	30,694
Occupancy	10,013	6,338	25,247	12,737
Advertising and promotion	4,376	5,306	12,210	10,459
Depreciation and amortization	5,225	4,693	9,915	9,120
Total operating expenses	88,935	81,150	202,432	159,810
Income (loss) before income taxes and minority interest	(69,234)	72,017	(317,296)	135,052
Income tax provision	5,159	28,272	14,770	52,990
Minority interest - dividends on preferred stock of subsidiary	2,494	2,495	4,989	4,989
Net income (loss)	\$ (76,887)	\$ 41,250	\$ (337,055)	\$ 77,073
Earnings (loss) per common share:				
Basic	\$ (3.03)	\$ 1.90	\$ (13.31)	\$ 3.57
Diluted	\$ (3.03)	\$ 1.84	\$ (13.31)	\$ 3.45
Weighted average shares outstanding:				
Basic	25,355	21,676	25,318	21,615
Diluted	25,355	22,358	25,318	22,336

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

ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands) (Unaudited)

	Six Months Ended June 30,	
	2007	2006
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	\$ (337,055)	\$ 77,073
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	9,915	9,120
Provision for losses on mortgage loans held for investment	57,470	29,599
Provision for losses on repurchases and premium recapture	28,396	7,143
Minority interest dividends paid on preferred stock of subsidiary	4,989	4,989
Deferred income tax provision (benefit)	3,055	(22,479)
Unrealized (gain) loss on derivatives	(20,750)	25,959
Adjustment into earnings for gain on derivatives from other comprehensive income	(10,736)	(16,278)
Stock-based compensation expense	6,492	5,013
Excess tax benefit from stock-based payment arrangements	(254)	(3,341)
Other	5,674	4,570
Changes in operating assets and liabilities:		
Restricted cash	54,592	5,285
Mortgage loans held for sale originated, net of fees	(3,510,237)	(7,634,129)
Cost of mortgage loans sold, net of fees	4,679,540	6,597,356
Principal payments received and other changes in mortgage loans held for sale	18,083	84,239
Accrued interest receivable	18,791	(3,052)
Derivative assets, including margin account	63,096	23,545
Prepaid expenses and other assets	(16,547)	(19,660)
Income taxes payable	13,114	(63,227)
Accrued expenses and other liabilities	(138,518)	(7,823)
Net cash provided by (used in) operating activities	929,110	(896,098)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Principal payments received and other changes in mortgage loans held for investment	1,312,267	1,134,685
Capital expenditures	(5,168)	(10,434)
Net cash provided by investing activities	1,307,099	1,124,251
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net changes in credit facilities mortgage loans held for sale	(1,928,959)	(1,252,990)
Proceeds from issuance of securitization and other financing, net of fees	785,702	2,197,532
Payments on securitization and other financing	(1,308,290)	(1,154,255)
Net proceeds from issuance of common stock through employee stock plans	76	826
Net proceeds from issuance of term debt and warrants, net of fees	226,700	
Net proceeds from issuance of trust preferred securities, net of fees	54,209	
Excess tax benefit from stock-based payment arrangements	254	3,341
Payment by consolidated subsidiary of preferred stock dividends	(4,989)	(4,989)
Net cash used in financing activities	(2,175,297)	(210,535)
Effect of exchange rate changes on cash	3,151	1,510
Net increase in cash and cash equivalents	64,063	19,128
Beginning balance, cash and cash equivalents	173,113	44,714

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Ending balance, cash and cash equivalents	\$ 237,176	\$ 63,842
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The accompanying notes are an integral part of these consolidated financial statements.

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 and six months ended June 30, 2007 are of a normal recurring nature. Operating results for the three and six months ended June 30, 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 loan origination operations pending the return of market conditions under which non-prime mortgage loans can be originated and sold or securitized at a profit. On October 15, 2007, Accredited resumed U.S. lending operations.

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 completed on October 12, 2007, and Lone Star now owns 100% of the common stock of the Company. The outstanding 9.75% Series A Perpetual Cumulative Preferred Shares, par value \$1.00 per share, of the REIT (NYSE: AHH.PrA) (the Series A Preferred Shares) remained outstanding following the consummation of the acquisition. On October 19, 2007, Accredited and the REIT announced their intention to deregister the Series A Preferred Shares and Accredited's guarantee with respect to those shares. As a prerequisite to such deregistration, the REIT requested the New York Stock Exchange (NYSE) to delist the Series A Preferred Shares from the NYSE and anticipates filing Form 15 with the Securities and Exchange Commission by November 8, 2007, at which time the public reporting obligations of Accredited and the REIT will be suspended.

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.

ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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 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.

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 Statement of Financial Accounting Standards (SFAS) No. 140, *Accounting for Transfer and Servicing of Financial Assets and Extinguishment of Liabilities* a replacement of FASB Statement No. 125 (SFAS 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

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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.

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 HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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.

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. No securitizations were completed during the three months ended June 30, 2007. For the three months ended June 2006 the Company closed a \$1.4 billion securitization. Collateral of \$1.1 billion in mortgage loans was delivered at closing and the balance of approximately \$350 million was delivered in July and August of 2006.

These securitizations are structured legally as sales, but for accounting purposes are treated as financings under SFAS 140. These securitizations do not meet the qualifying special purpose entity criteria under SFAS 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* (SFAS 133), as amended and interpreted, derivative financial instruments are reported on the consolidated balance sheets at their fair value.

ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)***Fair Value Hedges*

Accredited designates certain derivative financial instruments as hedge instruments under SFAS 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 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 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 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 earnings 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 (SOP) 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*. These projects, if any, 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

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

ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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 mortgage 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.

Mortgage Loan Servicing and Other Fees

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

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 \$133.0 million and \$147.4 million at June 30, 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). 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 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109 (SFAS109), *Accounting for Income Taxes* . 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. The Company adopted FIN 48 on January 1, 2007.

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 SFAS 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.

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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

ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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*. 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 Net Income (Loss)

Other comprehensive net income (loss) 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.

Comprehensive net income (loss) is determined as follows:

	Three Months Ended June 30, 2007		Six Months Ended June 30, 2006	
	2007	2006	2007	2006
	(in thousands)			
Net income (loss)	\$ (76,887)	\$ 41,250	\$ (337,055)	\$ 77,073
Net unrealized gains on cash flow hedges, net of taxes of \$1,765, \$9,570 \$1,765 and \$19,419, respectively	14,509	17,082	624	32,827
Reclassification adjustment into earnings for realized gain on derivatives, net of taxes of \$430, \$3,510, \$2,795 and \$6,251, respectively	(4,004)	(5,705)	(7,940)	(10,048)
Foreign currency translation adjustments	6,578	1,217	7,213	1,372
Total comprehensive net income (loss)	\$ (59,804)	\$ 53,844	\$ (337,158)	\$ 101,224

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 of Directors, 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. Accredited did not repurchase any shares during the six months ended June 30, 2007. The repurchase plan expired on October 1, 2007.

Recently Issued Accounting Pronouncements

In September 2006, the FASB issued SFAS 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 financial impact, if any, on the Company upon adoption on January 1,

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2008, has not yet been determined.

In February 2007, the FASB issued SFAS 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

ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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:

	June 30, 2007	December 31, 2006
	(in thousands)	
Canada mortgage loan financing conduit collateral (see Note 7)	\$18,665	\$17,825
Cash in escrow on Canadian mortgage loans pending closing	10,853	4,504
Letters of credit and other	12,648	9,259
Reserve account in connection with asset-backed commercial paper facility (see Note 6)		65,170
Total restricted cash	\$42,166	\$96,758

3. CONCENTRATIONS OF RISK**Significant Customers**

During the three months ended June 30, 2007, Accredited sold \$0.5 billion and \$0.4 billion in mortgage loans to two separate investors, which represented 52% and 35%, respectively, of total mortgage loans sold. During the three months ended June 30, 2006, Accredited sold \$1.0 billion, \$0.8 billion, \$0.7 billion and \$0.5 billion in mortgage loans to four separate investors, which represented 26%, 22%, 19%, 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 June 30, 2007 and 2006.

During the six months ended June 30, 2007, Accredited sold \$2.7 billion, \$0.6 billion, and \$0.5 billion in mortgage loans to three separate investors, which represented 60%, 12%, 12%, respectively, of total mortgage loans sold. During the six months ended June 30, 2006, Accredited sold \$2.0 billion, \$1.0 billion, \$1.0 billion, \$1.0 billion, and \$0.7 billion in loans to five separate investors, which represented 29%, 14%, 14%, 14%, and 11%, respectively, of total mortgage loans sold. No other sales to individual investors accounted for more than 10% of total mortgage loans sold during the six months ended June 30, 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 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 June 30, 2007 and 2006, mortgage loans repurchased totaled \$105.2 million and \$38.6 million, respectively, and during the six months ended June 30, 2007 and 2006, mortgage loans repurchased totaled \$192.5 million and \$53.1 million, respectively, pursuant to these provisions. At June 30, 2007 and December 31, 2006, the reserve for potential future repurchase losses (see Note 9) totaled \$45.7 million and \$106.1 million, respectively.

Mortgage Loan Products

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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 mortgage loan-to-value ratios (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.

ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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.

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 June 30, 2007 and 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 June 30, 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 June 30, 2007, 15% and 16% of loans originated were collateralized by properties located in California and Florida, respectively. During the three months ended June 30, 2006, 15% and 12% of loans originated were collateralized by properties located in California and Florida, respectively. During the six months ended June 30, 2007, 15% and 16% of loans originated were collateralized by properties located in California and Florida, respectively. During the six months ended June 30, 2006, 15% and 12% of 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:

	June 30, 2007	December 31, 2006
	(in thousands)	
Mortgage loans held for sale (1)	\$ 1,021,441	\$ 2,119,509
Basis adjustment for fair value hedge accounting	249	2,283
Net deferred origination fees	(10,038)	(11,999)

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Market valuation allowance (LOCOM)	(40,060)	(36,525)
Mortgage loans held for sale, net	\$ 971,592	\$ 2,073,268

(1) Includes \$80.3 million of Canadian loans at June 30, 2007.

ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Mortgage loans held for investment

Mortgage loans held for investment were as follows:

	June 30, 2007	December 31, 2006
	(in thousands)	
Mortgage loans securitized	\$ 7,173,918	\$ 7,783,432
Mortgage loans held for securitization (1)		883,313
Basis adjustment for fair value hedge accounting	(8,601)	(10,971)
Net deferred origination fees	(29,592)	(38,842)
Allowance for loan losses	(144,160)	(138,250)
 Mortgage loans held for investment, net	 \$ 6,991,565	 \$ 8,478,682

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

Reserve for Losses

Activity in the reserves was as follows:

	Balance at Beginning of Period	Provision for Losses (in thousands)	Chargeoffs, net	Balance at End of Period
Three Months Ended June 30, 2007:				
Mortgage loans held for investment	\$ 136,647	\$ 9,988	\$ (2,475)	\$ 144,160
Real estate owned	59,625	22,158	(7,878)	73,905
Total	\$ 196,272	\$ 32,146	\$ (10,353)	\$ 218,065
2006:				
Mortgage loans held for investment	\$ 115,704	\$ 10,109	\$ (424)	\$ 125,389
Real estate owned	13,702	2,953	(3,871)	12,784
Total	\$ 129,406	\$ 13,062	\$ (4,295)	\$ 138,173
Six Months Ended June 30, 2007:				
Mortgage loans held for investment	\$ 138,250	\$ 10,431	\$ (4,521)	\$ 144,160
Real estate owned	40,364	47,039	(13,498)	73,905
Total	\$ 178,614	\$ 57,470	\$ (18,019)	\$ 218,065

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2006:				
Mortgage loans held for investment	\$ 106,017	\$ 20,032	\$ (660)	\$ 125,389
Real estate owned	10,725	9,567	(7,508)	12,784
Total	\$ 116,742	\$ 29,599	\$ (8,168)	\$ 138,173

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):

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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 June 30,	
	2007	2006
Hedge ineffectiveness gains	\$ 2,995	\$ 600

	Six Months Ended June 30,	
	2007	2006
Hedge ineffectiveness gains	\$ 7,966	\$ 1,100

	Interest Income	Interest Expense	Gain on Sale (in thousands)	Total
Three Months Ended June 30,				
2007:				
Net unrealized gain	\$ 1,814	\$ 5,009	\$ 118	\$ 6,941
Net realized gain		3,552	4,348	7,900
Total	\$ 1,814	\$ 8,561	\$ 4,466	\$ 14,841
2006:				
Net unrealized gain (loss)	\$ 1,304	\$ (9,450)	\$ (8,113)	\$ (16,259)
Net realized gain		19,339	20,430	39,769
Total	\$ 1,304	\$ 9,889	\$ 12,317	\$ 23,510
Six Months Ended June 30,				
2007:				
Net unrealized gain (loss)	\$ 3,635	\$ 25,489	\$ (8,374)	\$ 20,750
Net realized gain (loss)		(4,494)	548	(3,946)
Total	\$ 3,635	\$ 20,995	\$ (7,826)	\$ 16,804
2006:				
Net unrealized gain (loss)	\$ 1,977	\$ (15,395)	\$ (12,541)	\$ (25,959)
Net realized gain		32,801	28,863	61,664
Total	\$ 1,977	\$ 17,406	\$ 16,322	\$ 35,705

ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

6. CREDIT FACILITIES-MORTGAGE LOANS HELD FOR SALE

Committed credit facilities for mortgage loans held for sale (warehouse credit facilities) consisted of the following:

	June 30,	December 31,
	2007	2006
	(in thousands)	
\$750 million warehouse credit facility expiring March 2008	\$ 512,556	\$
\$600 million warehouse credit facility expiring March 2008 (1)	324,082	44,785
\$650 million warehouse credit facility expired July 2007	9,385	358,504
\$75.5 million warehouse credit facility expired July 2007 (2)	32,290	96,926
\$141.6 million warehouse credit facility expiring June 2008 (2)		
\$300 million warehouse credit facility terminated April 2007		150,051
\$600 million warehouse credit facility expired August 2007		301,462
\$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 in asset-backed commercial paper terminated May 2007		879,813
Total credit facilities	\$ 878,313	\$ 2,786,077

(1) Interest at overnight LIBOR plus a specified spread.

(2) Interest at one-month Bankers Acceptance rate plus a spread.

The outstanding warehouse facilities accrued interest based on one-month LIBOR, overnight LIBOR or, for Canada, one-month Bankers Acceptance rate for Canada, in each case plus a spread. The spread varied depending on the mortgage asset class being financed. The interest rates ranged from 5.82% to 6.57% as of June 30, 2007.

The warehouse facilities are 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 voluntarily 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 other 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 October 17, 2007, several of the covenant requirements were amended or waived to allow Accredited to remain 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 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.

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 a term loan agreement (see Note 7) providing cash and liquidity which was used to repay many of the warehouse facilities, after which such facilities were terminated or allowed to expire. Specifically, by August 31, 2007 the Company had repaid and terminated, or allowed to expire, the warehouse facilities provided by Lehman Brothers Bank, FSB, by Residential Funding Company, LLC, by Goldman Sachs Mortgage Company, by Merrill Lynch Bank USA, by Morgan Stanley Mortgage Capital Holdings LLC, by Natixis Real Estate Capital Inc. (formerly known as IXIS Real Estate Capital Inc.) and by Merrill Lynch Canada 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, on March 29, 2007, 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 28, 2008, and the maximum committed amount available for borrowing remained at \$600 million. Under the agreement with Wachovia, as subsequently amended on May 1, 2007 and on July 5, 2007, the term of the Wachovia repurchase facility was extended through March 25, 2008, and the maximum committed amount available for borrowing was increased to \$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 into 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:

	June 30,	December 31,
	2007	2006
	(in thousands)	
Securitized bond financing	\$ 6,760,948	\$ 7,281,479
Canadian mortgage loan financing conduit	345,431	345,260
Other borrowings	327,025	24,742
	7,433,404	7,651,481
Unamortized discounts	(22,668)	(8,639)
Total financing, net	\$ 7,410,736	\$ 7,642,842

Securitized Bond Financing

At June 30, 2007, securitized bond financing included 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 were collateralized by mortgage loans held for investment with an aggregate principal balance outstanding of \$6.9 billion and \$7.5 billion at June 30, 2007 and December 31, 2006, respectively. Unamortized debt issuance costs included in prepaid expenses and other assets were \$20.8 million and \$23.1 million at June 30, 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 are 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 over-collateralization. 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

ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

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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.

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 outstanding principal balance of \$350.3 and \$351.0 million at June 30, 2007 and December 31, 2006, respectively, which are included in mortgage loans held for investment. In addition, \$18.7 million and \$17.8 million at June 30, 2007 and December 31, 2006, respectively, of restricted cash is pledged as collateral (see Note 2).

Other Borrowings

Accredited also maintains a Senior Secured Credit Agreement which 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 \$41.0 million and \$8.4 million at June 30, 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 modified the definition of Adjusted Tangible Net Worth to include the amount of the Company's trust preferred securities (see below). 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 September 19, 2007, the lender's obligations under this facility were assumed by Lone Star and the \$34 million cap on borrowings under the facility was removed such that the maximum amount that can be borrowed under the facility is \$49 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 Farallon Loan, 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 June 30, 2007 the balance outstanding under this agreement was \$214.2 million, net of the discount, which represented the fair value of the warrants at March 30, 2007. The warrants are included in accrued expenses and other liabilities at their current fair value of \$15.7 million at June 30, 2007 because the Company was required under certain circumstances to purchase the warrants from the holder pursuant to put rights. In connection with the Lone Star merger, the warrants were cancelled in exchange for a per share cash payment by Lone Star equal to the difference between the \$11.75 per share price offered by Lone Star for the Company's common stock and the \$10 per share exercise price of the warrants. The warrants have been adjusted to estimated fair value at the end of each quarter since the warrants were granted. Subsequent to June 30, 2007 MIF exercised its option under the change of control provisions of the Loan Agreement to demand payment (see Note 16).

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 June 30, 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).

ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table summarizes the expected repayments relating to the securitization and other financing at June 30, 2007:

	(in thousands)
Six months ending December 31, 2007	\$ 1,447,153
Years ending December 31:	
2008	1,982,190
2009	1,293,872
2010	798,040
2011	483,720
2012	529,565
Thereafter	898,864
Total	\$ 7,433,404

8. INCOME TAXES

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amount 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) assets were as follows:

	June 30, 2007	December 31, 2006
	(in thousands)	
Deferred tax assets:		
Net operating losses	\$ 212,825	\$ 26,200
Market reserve on mortgage loans held for sale	34,244	40,457
Loan securitizations	108,328	111,348
State taxes	81	1,291
Other reserves and accruals	53,085	71,726
Total deferred tax assets	408,563	251,022
Deferred tax liabilities:		
Mortgage loans held for sale	(21,786)	(6,858)
Mortgage-related securities	(8,393)	(8,239)
Cash flow hedging	(2,195)	(3,225)
Total deferred tax liabilities	(32,374)	(18,322)
Net deferred tax asset before valuation allowance	376,189	232,700
Valuation allowance	(257,654)	(112,140)
Net deferred tax asset after valuation allowance	\$ 118,535	\$ 120,560

The income tax provision consists of the following:

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	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
	(in thousands)			
Current:				
Federal	\$ 1,939	\$ 37,380	\$ 5,092	\$ 61,267
Foreign	2,838		5,838	
State	297	8,073	785	14,202
Total current provision	5,074	45,453	11,715	75,469
Deferred:				
Federal	19	(14,364)	3,225	(18,061)
State	66	(2,817)	(170)	(4,418)
Total deferred provision (benefit)	85	(17,181)	3,055	(22,479)
Total provision	\$ 5,159	\$ 28,272	\$ 14,770	\$ 52,990

ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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 mortgage securitizations where taxable income has been recognized in excess of book income and various reserves and accruals in which book deductions exceed tax deductions.

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 June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
	(in thousands)			
Federal income tax at statutory rate	\$ (23,627)	\$ 25,206	\$ (110,450)	\$ 47,268
State income tax, net of federal effects	(4,231)	3,417	(19,206)	6,360
Federal/state valuation allowance	33,919		144,867	
REIT dividends on preferred stock	(873)	(873)	(1,746)	(1,746)
Other	(29)	522	1,305	1,108
Total provision	\$ 5,159	\$ 28,272	\$ 14,770	\$ 52,990

For the six months ended June 30, 2007 the Company has recognized tax expense of \$14.8 million against a net loss before income taxes of \$317.3 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 \$257.7 million has been established decreasing the total accumulated net deferred tax asset of \$376.2 million to the \$118.5 million reported in the table above. The net deferred tax asset primarily 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.

In July 2006, the FASB issued FIN 48 that clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with SFAS 109, and prescribes a recognition threshold and measurement attributes for financial statement disclosure of tax positions taken or expected to be taken on a tax return. Under FIN 48, the impact of an uncertain income tax position must be recognized at the largest amount that is more-likely-than-not to be sustained upon audit by the relevant taxing authority. An uncertain income tax position will not be recognized if it has less than a 50% likelihood of being sustained. Additionally, FIN 48 provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

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 carry-forwards.

ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Through the second quarter of 2007, the Company's liability for unrecognized tax benefits was increased by \$0.3 million to a balance of \$9.5 million at June 30, 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:

	June 30, 2007	December 31, 2006
	(in thousands)	
Accrued liabilities - payroll	\$ 21,679	\$ 28,591
Accrued liabilities - merger transaction and direct acquisition costs	15,234	23,084
Accrued liabilities - general	80,755	71,769
Derivative liabilities	2,542	31,703
Reserve for repurchases and premium recapture	48,847	110,909
Total	\$ 169,057	\$ 266,056

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

	Balance at			Balance at
	Beginning	Additions to	Losses	End of
	of Period	Reserves	Incurred (2)	Period
	(in thousands)			
Three Months Ended June 30, 2007:				
Mortgage loans held for investment	\$ 57,851	\$ 4,296	\$ (16,426)	\$ 45,721
Real estate owned	3,902	(294)	(482)	3,126
Total	\$ 61,753	\$ 4,002	\$ (16,908)	\$ 48,847
2006:				
Mortgage loans held for investment	\$ 8,042	\$ 1,864	\$ (1,220)	\$ 8,686
Real estate owned	3,588	2,125	(1,837)	3,876
Total	\$ 11,630	\$ 3,989	\$ (3,057)	\$ 12,562
Six Months Ended June 30, 2007:				
Mortgage loans held for investment	\$ 106,111	\$ 26,346	\$ (86,736)	\$ 45,721
Real estate owned	4,798	2,050	(3,722)	3,126
Total	\$ 110,909	\$ 28,396	\$ (90,458)	\$ 48,847

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2006:				
Mortgage loans held for investment	\$ 7,434	\$ 2,913	\$ (1,661)	\$ 8,686
Real estate owned	3,317	4,230	(3,671)	3,876
Total	\$ 10,751	\$ 7,143	\$ (5,332)	\$ 12,562

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- (1) Reduces gain on sale of mortgage loans in the accompanying consolidated statement of operations.
(2) Losses include cash settlements with investors to eliminate future repurchases.

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.

ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

11. GAIN (LOSS) ON WHOLE LOAN SALES

The components of gain (loss) on sale of mortgage loans were as follows for the three and six months ended June 30, 2007 and 2006 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Gross gain (loss) on sale of mortgage loans	\$ 14,645	\$ 79,991	\$ (132,528)	\$ 143,851
Net gain (loss) on derivatives	4,466	12,317	(7,826)	16,322
Provisions for market valuation (LOCOM), repurchases, and premium recapture	(38,598)	(19,600)	(92,009)	(22,058)
Net origination points and fees	21,431	20,757	66,435	39,293
Direct mortgage loan origination expenses	(3,501)	(12,792)	(14,507)	(26,182)
Gain (loss) on sale of mortgage loans, net	\$ (1,557)	\$ 80,673	\$ (180,435)	\$ 151,226

12. STOCK-BASED COMPENSATION

Prior to the merger with Lone Star, Accredited had 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), provided 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 consisted of the number of shares remaining available for option grants and the number of options outstanding under all stock option plans.

Stock options were generally granted with an exercise price equal to the closing market price on the date of grant, had a term of 10 years and vested 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 options granted during 2007 were granted at 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 and six months ended June 30, 2007 and 2006 are noted in the following table:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Weighted-average risk-free rate	4.57%	4.96%	4.76%	4.74%
Weighted-average expected life	3.9 yrs	3.9 yrs	3.8 yrs	3.9 yrs
Expected volatility	87%	43%	50%	43%
Dividend yield	0%	0%	0%	0%
Weighted-average grant date fair value	\$ 7.40	\$ 21.13	\$ 9.79	\$ 19.77

A summary of the change in options outstanding under Accredited's Stock Option Plans during the six months ended June 30, 2007, follows:

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	Number of Options	Weighted- Average Exercise Price
	(in thousands)	
Outstanding at December 31, 2006	1,523	\$ 32.49
Options granted	581	\$ 25.52
Options exercised	(47)	\$ 5.51
Options cancelled	(464)	\$ 34.44
Outstanding at June 30, 2007	1,593	\$ 30.19
Options exercisable at June 30, 2007	735	\$ 24.87

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

For the three and six months ended June 30, 2007, approximately \$1.4 and \$3.0 million of compensation expense related to stock options was recorded, respectively. At June 30, 2007 Accredited had \$1.7 million of net unrecognized compensation expense related to the stock option plans that will be recognized in future periods.

In connection with the merger with Lone Star, all outstanding stock options were cancelled and no further options will be granted under the Stock Option Plans.

Deferred Compensation Plan

Accredited's Deferred Compensation Plan (the "DCP") 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. Prior to September 1, 2007, participants under the plan could defer up to 100% of their base salary, director fee, bonus and/or commissions on a pre-tax basis. Effective for compensation earned after September 1, 2007, the plan was amended to suspend all such deferrals. The DCP 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 and six months ended June 30, 2007 was \$11.68, and \$27.01, respectively. The per share weighted-average grant date fair value of units granted during the three and six months ended June 30, 2006 was \$57.79 and \$52.30, respectively.

A summary of the change in RSUs outstanding under Accredited's DCP during the six months ended June 30, 2007, follows:

	Units (in thousands)
Outstanding at December 31, 2006	655
Granted	93
Released	(59)
Forfeited	(50)
Outstanding at June 30, 2007	639
Units vested not converted	245

For the three and six months ended June 30, 2007, approximately \$1.5 and \$3.2 million of compensation expense related to restricted stock units was recorded.

In connection with the merger with Lone Star, all outstanding RSUs under the DCP were converted into cash accounts in the amount of \$11.75 per RSU with each such account remaining subject to the same vesting and distribution restrictions as the related RSUs, and no further RSUs will be granted under the DCP.

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 six months ended June 30, 2007 follows:

ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Awards (in thousands)
Outstanding at December 31, 2006	36
Granted	
Released	(12)
Forfeited	
Outstanding at June 30, 2007	24

For the three and six months ended June 30, 2007, approximately \$0.1 and \$0.2 million of compensation expense related to restricted stock units was recorded, respectively.

During the three months ended June 30, 2007, Accredited did not grant additional restricted stock awards. In connection with the acquisition by Lone Star, all outstanding restricted stock awards were fully vested and converted into cash in the amount of \$11.75 per share, and no further restricted stock awards will be granted.

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 (loss) were divided by the weighted average number of common shares and unvested, restricted common stock units, plus potential common shares from outstanding stock options, unvested restricted stock units, and warrants 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 June 30, 2007:			
Basic earnings (loss) per share	\$ (76,887)	25,355	\$ (3.03)
Effect of dilutive shares:			
Stock options			
Restricted stock units			
Warrants			
Diluted earnings (loss) per share	\$ (76,887)	25,355	\$ (3.03)
Potentially dilutive shares not included above since they are antidilutive		2,554	
Three Months Ended June 30, 2006:			
	\$ 41,250	21,676	\$ 1.90
Effect of dilutive shares:			
Stock options		462	
Restricted stock units		220	
Diluted earnings per share	\$ 41,250	22,358	\$ 1.84

Potentially dilutive shares not included above since they are antidilutive

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ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Net Income (numerator) (in thousands, except per share amounts)	Shares (denominator)	Per Share Amount
Six Months Ended June 30, 2007:			
Basic earnings (loss) per share	\$ (337,055)	25,318	\$ (13.31)
Effect of dilutive shares:			
Stock options			
Restricted stock units			
Warrants			
Diluted earnings (loss) per share	\$ (337,055)	25,318	\$ (13.31)
Potentially dilutive shares not included above since they are antidilutive		2,198	
Six Months Ended June 30, 2006:			
Basic earnings per share	\$ 77,073	21,615	\$ 3.57
Effect of dilutive shares:			
Stock options		480	
Restricted stock units		241	
Diluted earnings per share	\$ 77,073	22,336	\$ 3.45
Potentially dilutive shares not included above since they are antidilutive		372	

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 on 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 \$528 million as of June 30, 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 June 30, 2007 forward loan sale commitments awaiting settlement amounted to \$41 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 was in compliance with these requirements at June 30, 2007.

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

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recorded for these obligations on its balance sheet as of June 30, 2007.

Accredited has irrevocably and unconditionally agreed 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 10 Minority Interest in REIT Subsidiary.

Legal Matters-

In October 2007, as a result of the merger with Lone Star, AHLHC succeeded to the position of LSF5 Accredited Merger Co., Inc., as a defendant in a class action lawsuit, *McNeil, et al. v. Lone Star Fund V (U.S.), L.P., et al.*, brought in the United States District Court for the Central District of California. The complaint alleges that the failure of defendants to consummate the purchase of AHLHC at the original price of \$15.10 per share constitutes a breach of contract as to each of the defendants and a breach of guaranty by defendant Lone Star Fund V (U.S.), L.P. The plaintiffs seek to recover, on behalf of themselves and similarly situated individuals, damages, attorneys' fees, and any other relief the court may grant. AHLHC has not been served with the complaint, 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, and intends to vigorously defend this action if served. The ultimate outcome of this matter and the amount of liability, if any, which may result is not presently determinable, and legal counsel cannot express an opinion as to the extent of the Company's possible loss, if any, in the lawsuit. 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 financial position and results of operations.

In October 2007, AHLHC and AHL were named in a class action complaint, *Seigel v. Accredited Home Lenders, Inc. et al.*, brought in the Superior Court of the State of California, County of Los Angeles. The complaint alleges that AHLHC and 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. Neither AHLHC nor AHL has 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. The Company intends 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, and legal counsel cannot express an opinion as to the extent of the Company's possible loss, if any, in the lawsuit, but the Company does not believe it will have a material adverse effect on its financial position or results of operations.

ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In September 2007, AHLHC and AHL were served with a class action complaint, *Hayes v. Accredited Home Lenders Holding, Co. et al.*, brought in the United States District Court for the Southern District of California. The complaint alleges that AHLHC and AHL 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 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 been filed, and there has been no ruling on the merits of either the plaintiffs' individual claims or the claims of the putative class, and the Company intends 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, and legal counsel cannot express an opinion as to the extent of the Company's possible loss, if any, in the lawsuit, but the Company does not believe it will have a material adverse effect on its financial position or results of operations.

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, there has been no ruling on the merits of either the plaintiffs' individual claims or the claims of the putative class, and AHLHC and AHL intend to vigorously defend this matter. The ultimate outcome of this matter and the amount of liability, if any, which may result is not presently determinable, and legal counsel cannot express an opinion as to the extent of the Company's possible loss, if any, in the lawsuit, but the Company does not believe it will have a material adverse effect on its financial position or results of operations.

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 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, 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 vigorously defend this matter. The ultimate outcome of this matter and the amount of liability, if any, which may result is not presently determinable, and legal counsel cannot express an opinion as to the extent of the Company's possible loss, if any, in the lawsuit, but the Company does not believe it will have a material adverse effect on its financial position or results of operations.

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 alleged 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 sought specific performance of the contractual obligations or, in the alternative, damages for breach of contract. On September 21, 2007, the parties entered into a settlement agreement and filed a stipulation and order staying the litigation pending performance under the settlement agreement and the Merger Agreement, as amended. Upon the completion of Lone Star's acquisition of the Company, the action was dismissed with prejudice.

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 suffer any material loss in this lawsuit or that it will have a material adverse effect on its financial position or results of operations.

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

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 the Company does not believe it will suffer any material loss in this lawsuit or that it will have a material adverse effect on its financial position or results of operations.

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 sought to enjoin the tender offer for AHLHC common stock which was pending under the Merger Agreement, and recovery of attorneys' fees and costs of suit. The *Korsinski* matter was voluntarily dismissed by the plaintiff without prejudice. The *Wan* matter has been resolved, subject to a fairness hearing, for an amount immaterial to the Company's financial condition or results of operations.

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 consolidated, amended complaint was filed on August 24, 2007, and added as defendants the REIT and certain directors of AHLHC. AHLHC's and the REIT's response to this complaint is currently scheduled to be due October 26, 2007. 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 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, and legal counsel cannot express an opinion as to the extent of the Company's possible loss, if any, in the consolidated lawsuit. However, the Company believes that any loss in this matter will be substantially or completely covered by insurance and that this matter will not have a material adverse effect on the Company's financial position or results of operations.

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, and legal counsel cannot express an opinion as to the extent of the Company's possible loss, if any, in the lawsuit, but the Company does not believe it will have a material adverse effect on its financial position or results of operations.

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,

ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

which may result is not presently determinable, and legal counsel cannot express an opinion as to the extent of the Company's possible loss, if any, in the lawsuit, but the Company does not believe it will have a material adverse effect on its financial position or results of operations.

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, and legal counsel cannot express an opinion as to the extent of the Company's possible loss, if any, in the lawsuit. 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 financial position and results of operations.

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. Plaintiff's motion for class certification was withdrawn prior the hearing previously scheduled for October 1, 2007, and the matter has been settled, subject to a fairness hearing, for an amount immaterial to the Company's financial condition or results of operations.

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 plaintiff's 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, plaintiff 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 this matter. The ultimate outcome of this matter and the amount of liability, if any, which may result is not presently determinable, and legal counsel cannot express an opinion as to the extent of the Company's possible loss, if any, in the lawsuit, but the Company does not believe it will have a material adverse effect on its financial position or results of operations.

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. On September 14, 2007, the Ninth Circuit Court of Appeals denied the Petition filed by AHL and AHLHC. This matter has been settled, subject to a fairness hearing, for an amount immaterial to the Company's financial condition and results of operations.

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

In January 2004, AHL was served with a complaint, *Yturralde 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 Yturralde 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 approximately \$1.8 million, which was accrued for in 2006.

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, and legal counsel cannot express an opinion as to the extent of the Company's possible loss, if any, in the lawsuit, but the Company does not believe it will have a material adverse effect on its financial condition or results of operations.

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.

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:

Six Months Ended June 30,
2007 2006
(in thousands)

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:

Cash paid (received) during the period for:

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Interest	\$ 266,892	\$ 211,418
Income taxes	\$ (19,146)	\$ 138,696
SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Transfer of mortgage loans held for sale to mortgage loans held for investment	\$	\$ 2,053,827
Transfer of mortgage loans held for sale to real estate owned, net of reserve	\$ 43,007	\$ 14,460
Transfer of mortgage loans held for investment to real estate owned, net of reserve	\$ 92,863	\$ 20,439

ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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 and our 10-Q for the first quarter of 2007 on September 18, 2007. On October 1, 2007 the Panel determined to continue listing our common stock provided that we file with the SEC our 10-Q for the second quarter of 2007 by November 1, 2007. As a result of the Lone Star merger, our common stock is 100% owned by Lone Star and is no longer publicly traded, and our common stock has been delisted from NASDAQ.

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 was 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 would be converted into the same \$15.10 cash per share price paid in the tender offer. On September 18, 2007 the merger agreement was amended to, among other things, reduce the acquisition price to \$11.75 per share, and the acquisition was completed at that price on October 12, 2007. The outstanding 9.75% Series A Preferred Shares, par value \$1.00 per share, of Accredited Mortgage Loan REIT Trust remained outstanding following the consummation of the acquisition.

On August 17, 2007 AHL entered into a transaction treated as a financing for accounting purposes. The transaction includes a call provision exercisable by AHL which results in the transaction failing to qualify for sale treatment in accordance with certain provisions of SFAS 140. Under the transaction, AHL agreed to trade approximately \$1 billion of loans at an advance rate of 92.25% of the original principal balance of the mortgage loans traded, which is comparable to the advance rates AHL 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 were scheduled to trade every other week as borrowers made their first payments due under the subject loans. As of October 16, 2007, \$976 million of the original pool had been settled, with the final settlement of loans expected to occur by the end of October 2007. Under the agreement, AHL has the right but not the obligation, in its sole discretion, to reacquire all of the loans traded through mid-November 2007 at a premium of approximately 3% of the original principal balance of the mortgage loans traded or approximately \$30 million dollars. If AHL does not reacquire the loans by mid-November, its right to reacquire the loans expires and the investor will keep the loans with limited recourse to AHL, and AHL would then recognize the transaction as a sale.

Beginning in September 2007, the Company implemented a restructuring that included 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. The cost of this restructure including lease costs, fixed asset impairment and personnel costs is estimated at approximately \$35 million. This charge will be recorded in the third quarter of 2007.

ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

On September 19, 2007, pursuant to the September 18, 2007 amendment of the merger agreement with Lone Star, Lone Star assumed the lender's obligations under AHL's Senior Secured Credit Agreement secured by mortgage servicing rights and servicing advances related to Accredited's securitizations. Lone Star agreed to remove the \$34 million cap under that facility and funded the facility up to its \$49 million limit, providing approximately \$15 million of additional liquidity for the Company.

On October 10, 2007, the Company received a letter from the lender under the Farallon Loan in which the lender stated that it was exercising its option under the change of control provisions of the Loan Agreement to demand payment, by the 30th business day following the Company's receipt of the letter, of the entire \$230 million outstanding balance of the loan, accrued interest thereon, and the 2% change of control premium provided for under the Loan Agreement. The Company expects to repay all amounts when due from available working capital, by financing certain assets currently securing the Farallon Loan, and with additional amounts contributed by Lone Star.

On October 12, 2007, the Company received a \$100 million capital contribution from its new parent, LSF5 Accredited Investments, LLC, a subsidiary of Lone Star Fund V (U.S.) L.P.

On October 15, 2007, the Company resumed U.S. lending operations.

On October 19, 2007, Accredited and the REIT announced their intention to deregister the Series A Preferred Shares and Accredited's guarantee with respect to those shares. As a prerequisite to such deregistration, the REIT requested the New York Stock Exchange (NYSE) to delist the Series A Preferred Shares from the NYSE and anticipates filing Form 15 with the Securities and Exchange Commission by November 8, 2007, at which time the public reporting obligations of Accredited and the REIT will be suspended.

ACCREDITED MORTGAGE LOAN REIT TRUST

BALANCE SHEETS

(in thousands, except per share data)

	June 30, 2007 (Unaudited)	December 31, 2006
ASSETS		
Cash and cash equivalents	\$ 64,752	\$ 23,299
Accrued interest receivable	44,561	52,708
Mortgage loans held for investment, net of allowance of \$141,342 and \$129,936, respectively	6,649,136	7,271,553
Derivative assets, including margin account	28,962	64,665
Real estate owned, net	132,520	65,854
Prepaid expenses and other assets	32,251	24,707
Receivable from parent	214,386	112,419
Total assets	\$ 7,166,568	\$ 7,615,205
LIABILITIES AND STOCKHOLDERS EQUITY		
LIABILITIES:		
Securitization and other financing	\$ 6,848,520	\$ 7,289,209
Accrued expenses and other liabilities	32,655	57,507
Total liabilities	6,881,175	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 June 30, 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	397,883	398,628
Accumulated other comprehensive income (loss)	(4,215)	7,947
Accumulated deficit	(112,370)	(142,181)
Total stockholders equity	285,393	268,489
Total liabilities and stockholders equity	\$ 7,166,568	\$ 7,615,205

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

ACCREDITED MORTGAGE LOAN REIT TRUST

STATEMENTS OF OPERATIONS

(in thousands, except per share amounts) (Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
REVENUES:				
Interest income (including \$3,022, \$2,459, \$5,375 and \$4,047 from parent)	\$ 137,998	\$ 134,905	\$ 287,707	\$ 260,625
Interest expense	(93,783)	(81,074)	(193,248)	(152,550)
Net interest income	44,215	53,831	94,459	108,075
Provision for losses on mortgage loans held for investment	(27,039)	(6,680)	(41,629)	(13,051)
Net interest income after provision	17,176	47,151	52,830	95,024
Other income	985	1,150	1,414	1,838
Total net revenues	18,161	48,301	54,244	96,862
OPERATING EXPENSES:				
Management fee assessed by parent	9,312	8,321	19,119	16,122
Direct general and administrative expenses	31	1	325	9
Total operating expenses	9,343	8,322	19,444	16,131
Net income	8,818	39,979	34,800	80,731
Dividends on preferred stock	(2,495)	(2,495)	(4,989)	(4,989)
Net income available to common stockholders	\$ 6,323	\$ 37,484	\$ 29,811	\$ 75,742
Basic and diluted earnings per common share	\$ 63.23	\$ 374.84	\$ 298.11	\$ 757.42
Weighted average shares outstanding for basic and diluted	100	100	100	100

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

ACCREDITED MORTGAGE LOAN REIT TRUST

STATEMENTS OF CASH FLOWS

(in thousands) (Unaudited)

	Six Months Ended June 30,	
	2007	2006
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 34,800	\$ 80,731
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of net deferred origination fees on securitized loans	(4,990)	(2,376)
Amortization of deferred costs	5,799	6,626
Provision for losses on mortgage loans held for investment	41,629	13,051
Unrealized (gain) loss on derivatives	(30,143)	13,213
Adjustment into earnings for gain on derivatives from other comprehensive income	(9,552)	(15,705)
Changes in operating assets and liabilities:		
Accrued interest receivable	8,147	(5,464)
Derivative assets, including margin account	59,894	5,664
Prepaid expenses and other assets	(24,277)	(7,074)
Accrued expenses and other liabilities	(30,498)	4,199
Net cash provided by operating activities	50,809	92,865
CASH FLOWS FROM INVESTING ACTIVITIES:		
Principal payments received on mortgage loans held for investment	1,280,667	1,113,821
Net cash provided by investing activities	1,280,667	1,113,821
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of securitization bond financing, net of fees	753,052	2,029,648
Proceeds from issuance of term debt and warrants, net of fees	98,557	
Payments on securitization bond financing	(1,292,423)	(1,145,953)
Payments on temporary credit facilities	(745,266)	(2,010,016)
Capital contributions from parent	3,013	8,388
Net increase in receivable from parent	(101,967)	(71,980)
Payments of common stock dividends		(12,300)
Payments of preferred stock dividends	(4,989)	(4,989)
Net cash used in financing activities	(1,290,023)	(1,207,202)
Net increase (decrease) in cash and cash equivalents	41,453	(516)
Beginning balance cash and cash equivalents	23,299	6,158
Ending balance cash and cash equivalents	\$ 64,752	\$ 5,642

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

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 and six months ended June 30, 2007 are of a normal recurring nature. Operating results for the three and six months ended June 30, 2007 are not necessarily indicative of the results that may be expected for the year ended December 31, 2007.

In addition, during the first quarter of 2007, Accredited engaged financial advisors to evaluate strategic alternatives for the Company. As a result, in June 2007, Accredited entered into an agreement with affiliates of Lone Star Fund V (U.S.) L.P. ("Lone Star"), pursuant to which Lone Star agreed to acquire all of Accredited's outstanding common stock through a tender offer and subsequent merger. The acquisition was completed on October 12, 2007 and Lone Star now owns 100% of the common stock of Accredited. The outstanding 9.75% Series A Perpetual Cumulative Preferred Shares, par value \$1.00 per share, of the REIT (NYSE: AHH.PrA) (the "Series A Preferred Shares") remained outstanding following the consummation of the acquisition. On October 19, 2007, Accredited and the REIT announced their intention to deregister the Series A Preferred Shares and Accredited's guarantee with respect to those shares. As a prerequisite to such deregistration, the REIT requested the New York Stock Exchange ("NYSE") to delist the Series A Preferred Shares from the NYSE and anticipates filing Form 15 with the Securities and Exchange Commission by November 8, 2007, at which time the public reporting obligations of Accredited and the REIT will be suspended.

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

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

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

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

Use of Estimates

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The preparation of financial statements 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.

ACCREDITED MORTGAGE LOAN REIT TRUST

NOTES TO UNAUDITED FINANCIAL STATEMENTS

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 June 30, 2007, the REIT did not securitize any loans. In June 2006 the Company closed a \$1.4 billion securitization of which \$1.1 billion in mortgage loans was delivered at closing and the remaining balance was delivered in July and August.

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

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

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* (SFAS 133), as amended and interpreted, derivative financial instruments are reported on the balance sheet at fair value.

ACCREDITED MORTGAGE LOAN REIT TRUST

NOTES TO UNAUDITED FINANCIAL STATEMENTS

Cash Flow Hedges

Pursuant to SFAS 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 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 of 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.

Other Comprehensive Net Income

Other comprehensive net 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 net income is determined as follows for the three and six months ended June 30:

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	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2007	2006	2007	2006
	(in thousands)			
Net income	\$ 8,818	\$ 39,979	\$ 34,800	\$ 80,731
Net unrealized gains (losses) on cash flow hedges	11,966	24,043	(2,610)	48,789
Reclassification adjustment into earnings for unrealized gain on derivatives	(3,198)	(8,817)	(9,552)	(15,705)
	\$ 17,586	\$ 55,205	\$ 22,638	\$ 113,815

ACCREDITED MORTGAGE LOAN REIT TRUST

NOTES TO UNAUDITED FINANCIAL STATEMENTS

2. CONCENTRATIONS OF RISK

Geographical Concentration

Properties securing mortgage loans held for investment are geographically dispersed throughout the United States. At June 30, 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, 19% and 15% 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 June 30, 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:

	June 30, 2007	December 31, 2006
	(in thousands)	
Mortgage loans held for investment	\$ 6,823,603	\$ 7,432,443
Basis adjustment for fair value hedge accounting	(8,601)	(10,971)
Net deferred origination fees	(24,524)	(19,983)
Allowance for loan losses	(141,342)	(129,936)
Loans held for investment, net	\$ 6,649,136	\$ 7,271,553

Activity in the allowance for losses on loans held for investment was as follows:

	Balance at			Balance at	
	Beginning	Contributions	Provision	End of	
	of Period	from Parent	for Losses	Period	
			Charge		
			offs, net		
			(in thousands)		
Three Months Ended June 30, 2007:					
Mortgage loans held for investment	\$ 133,716	\$	\$ 9,537	\$ (1,911)	\$ 141,342
Real estate owned	34,096		17,502	(2,618)	48,980
Total	\$ 167,812	\$	\$ 27,039	\$ (4,529)	\$ 190,322
2006:					
Mortgage loans held for investment	\$ 108,375	\$ 7,022	\$ 6,347	\$ (497)	\$ 121,247

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Real estate owned	9,686		333	(2,257)	7,762
Total	\$ 118,061	\$ 7,022	\$ 6,680	\$ (2,754)	\$ 129,009

**Six Months Ended June 30,
2007:**

Mortgage loans held for investment	\$ 129,936	\$ 4,676	\$ 10,070	\$ (3,340)	\$ 141,342
Real estate owned	22,783		31,559	(5,362)	48,980

Total	\$ 152,719	\$ 4,676	\$ 41,629	\$ (8,702)	\$ 190,322
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2006:

Mortgage loans held for investment	\$ 98,399	\$ 15,454	\$ 8,122	\$ (728)	\$ 121,247
Real estate owned	6,996		4,929	(4,163)	7,762

Total	\$ 105,395	\$ 15,454	\$ 13,051	\$ (4,891)	\$ 129,009
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ACCREDITED MORTGAGE LOAN REIT TRUST

NOTES TO UNAUDITED FINANCIAL STATEMENTS

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

	At June 30, 2007		At December 31, 2006	
	Total Principal Amount (1)	Delinquent Principal Over 90 Days	Total Principal Amount (1)	Delinquent Principal Over 90 Days
Mortgage loans held for investment	\$ 6,851,473	\$ 361,848	\$ 7,466,508	\$ 271,375
Real estate owned	181,500	181,500	88,637	88,637
Total	\$ 7,032,973	\$ 543,348	\$ 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 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 133. A total of \$0.5 million in net effective gains before taxes, included in other comprehensive income at June 30, 2007, is expected to be recognized in earnings during the next twelve months.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Hedge ineffectiveness recorded in earnings, included as a component of interest expense in the consolidated statements of operations:	\$ 3,034	\$ (800)	\$ 8,311	\$ 1,300
Effective unrealized gains, net of effective unrealized losses, recorded in other comprehensive income, reported as a component of stockholders' equity :	\$ 11,966	\$ 24,043	\$ (2,610)	\$ 48,789

ACCREDITED MORTGAGE LOAN REIT TRUST

NOTES TO UNAUDITED FINANCIAL STATEMENTS

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

	June 30, 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	703,310	87	630,342	2,803
Interest rate swaps	4,557,364	26,294	1,951,392	(665)
Interest rate caps	1,049,785	2,581	880,717	7
	\$ 6,310,459	28,962	\$ 7,221,425	7,115
Margin account balances	N/A		N/A	28,408
Total		\$ 28,962		\$ 35,523

The fair value of derivative liabilities of \$0 and \$29.1 million at June 30, 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 and six months ended June 30, 2007 and 2006 was as follows:

	Interest	Interest	Total
	Income	Expense (in thousands)	
Three Months Ended June 30, 2007:			
Net unrealized gain	\$ 1,814	\$ 5,398	\$ 7,212
Net realized gain		3,175	3,175
Total	\$ 1,814	\$ 8,573	\$ 10,387
2006:			
Net unrealized gain (loss)	\$ 1,304	\$ (9,307)	\$ (8,003)
Net realized gain		18,950	18,950
Total	\$ 1,304	\$ 9,643	\$ 10,947
Six Months Ended June 30, 2007:			
Net unrealized gain	\$ 3,635	\$ 26,508	\$ 30,143
Net realized loss		(5,683)	(5,683)
Total	\$ 3,635	\$ 20,825	\$ 24,460

2006:			
Net unrealized gain (loss)	\$ 1,977	\$ (15,190)	\$ (13,213)
Net realized gain		32,227	32,227
Total	\$ 1,977	\$ 17,037	\$ 19,014

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 June 30, 2007 the REIT had no obligations outstanding under these facilities.

ACCREDITED MORTGAGE LOAN REIT TRUST

NOTES TO UNAUDITED FINANCIAL STATEMENTS

6. SECURITIZATION AND OTHER FINANCING

Securitization and other financing consisted of the following:

	June 30, 2007	December 31, 2006
	(in thousands)	
Securitized Bond Financing	\$ 6,760,948	\$ 7,281,480
Other borrowings	100,000	16,368
	6,860,948	7,297,848
Unamortized bond discounts	(12,428)	(8,639)
Total financing, net	\$ 6,848,520	\$ 7,289,209

Securitized Bond Financing

At June 30, 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 are collateralized by mortgage loans held for investment with an aggregate principal balance outstanding of \$6.9 billion and \$7.5 billion at June 30, 2007 and at December 31, 2006, respectively. Unamortized debt issuance costs included in prepaid expenses and other assets were \$20.8 million and \$23.1 million at June 30, 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, Accredited and certain of its subsidiaries entered into a secured five year term Loan Agreement with Mortgage Investment Fundings, L.L.C. (MIF), a lending entity managed by Farallon Capital Management (the Farallon Loan). Pursuant to the Loan Agreement, MIF extended term loans guaranteed by Accredited in an aggregate principal amount of \$230,000,000 (\$130 million with AHL and \$100 million with the REIT). In conjunction with the Loan Agreement, Accredited (i) issued to MIF a warrant to purchase 3,226,431 shares of common stock of Accredited at an exercise price of \$10 per share and (ii) granted to MIF certain preemptive rights to purchase additional equity securities of Accredited, certain registration rights with respect to its equity securities in the Company and Board of Directors observer rights. The loans may be prepaid in full at any time, subject to payment of a premium of 7% of amounts prepaid during the first two years of the facility and a lesser premium thereafter. Upon the occurrence of a change of control, the lenders may demand prepayment of the loans and the loans shall be prepaid in full with a premium of 2% of the amount prepaid. At June 30, 2007 the balance outstanding in the REIT under this agreement was \$94.4 million which is net of the discount representing the fair value of the warrants at the time of issuance of \$5.6 million. The value of the warrants is included in accrued expenses and other liabilities since Accredited was required under certain circumstances to purchase the warrants from the

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holders pursuant to put rights. In connection with the Lone Star merger, the warrants were cancelled in exchange for a per share cash payment by Lone Star equal to the difference between the \$11.75 per share price offered by Lone Star for the Company's common stock and the \$10 per share exercise price of the warrants. The warrants have been adjusted to estimated fair value at the end of each quarter since the warrants were granted.

ACCREDITED MORTGAGE LOAN REIT TRUST

NOTES TO UNAUDITED FINANCIAL STATEMENTS

Our credit facilities contain extensive restrictions and covenants including minimum profitability, interest coverage, liquidity, and net worth requirements and limitations on other indebtedness. If Accredited fails to comply with any of these covenants or otherwise defaults under a facility, the lender has the right to terminate the facility and require immediate payment which may require sale of the collateral at less than optimal terms. In addition, if Accredited defaults under one facility, it would generally trigger a default under the other facilities. From January to October 17, 2007, several of the covenant requirements were amended or waived to allow Accredited to remain in compliance with all requirements. We anticipate requiring additional amendments to or waivers of these covenants during 2007, and there can be no assurance the lenders will so agree. In the event such amendments or waivers are required and Accredited is unable to obtain them, it could have a material and adverse impact on our ability to fund mortgage loans and continue as a going concern.

The following table summarizes the expected repayments relating to the securitization and other financing at June 30, 2007 and the securitized bonds are based on anticipated receipts of principal and interest on underlying mortgage loan collateral:

	(in thousands)
Six months ending December 31, 2007	\$ 1,376,228
Year ending December 31:	
2008	1,854,708
2009	1,144,246
2010	766,820
2011	476,514
2012	399,565
Thereafter	842,867
Total	\$ 6,860,948

7. INCOME TAXES AND DISTRIBUTION OF EARNINGS

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

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

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

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2007	2006	2007	2006
	(in thousands)			
Federal income tax at statutory rate	\$ 3,690	\$ 13,993	\$ 12,784	\$ 28,256
Preferred stock dividends at statutory rate	(873)	(873)	(1,746)	(1,746)
Common stock dividends paid deduction and other	(2,817)	(13,120)	(11,038)	(26,510)

Total provision	\$	\$	\$	\$
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ACCREDITED MORTGAGE LOAN REIT TRUST

NOTES TO UNAUDITED FINANCIAL STATEMENTS

8. ACCRUED EXPENSES AND OTHER LIABILITIES

Accrued expenses and other liabilities were as follows:

	June 30, 2007	December 31, 2006
	(in thousands)	
Accrued interest	\$ 7,568	\$ 7,894
Derivative liabilities		29,141
Other liabilities - general	22,592	17,977
Preferred stock dividend payable	2,495	2,495
Total	\$ 32,655	\$ 57,507

9. PREFERRED STOCK

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

9.75% Series A Perpetual Cumulative Preferred Shares

The Board of Trustees has classified and designated 4,093,678 preferred shares as Series A Preferred Shares. At June 30, 2007 and December 31, 2006, there were 4,093,678 preferred shares issued and outstanding.

In March and June 2007, the REIT's Board of Trustees declared quarterly cash dividends on the Preferred Shares at the rate of \$0.609375 per share to shareholders of record on March 15 and June 15, which aggregated \$5.0 million for the six months ended June 30, 2007.

The Series A Preferred Shares contain covenants requiring the REIT to maintain a total shareholders' equity balance and total loans held for investment of at least \$50.0 million and \$2.0 billion, respectively, commencing on December 31, 2004 and at the end of each quarter thereafter. In addition, commencing with each of the four quarters ending December 31, 2006, the REIT is also required to maintain cumulative unencumbered cash flow (as defined in the agreement) greater than or equal to six times the cumulative preferred dividends required in those four quarters. If the REIT is not in compliance with any of these covenants, no dividends can be declared on the REIT's common shares until it is in compliance with all covenants as of the end of two successive quarters. As of June 30, 2007, the REIT was in compliance with the covenants applicable to date in 2007.

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

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

The REIT has an administration and servicing agreement with its parent company, AHL, whereby AHL provides loan servicing, treasury, accounting, tax and other administrative services for the REIT in exchange for a management fee equal to 0.5% per year on the outstanding principal balance of the loans serviced, plus miscellaneous fee income collected from mortgagors including late payment charges, assumption

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fees and similar items. Under this agreement, either party agrees to pay interest on the net average balance payable to the other party at an annual rate equal to the six-month LIBOR plus 1.0%. Management fee expense under this agreement totaled \$9.3 million and \$8.3 million for the three months ended June 30, 2007 and 2006, respectively. Interest income under this agreement totaled \$2.4 million and \$2.5 million for the three months ended June 30, 2007 and 2006, respectively. Management fee expense under this agreement totaled \$19.1 million and \$16.1 million for the six months ended June 30, 2007 and 2006, respectively. Interest income under this agreement totaled \$5.4 million and \$4.0 million for the six months ended June 30, 2007 and 2006, respectively. At June 30, 2007 and December 31, 2006, the net receivable from parent was \$214.4 million and \$112.4 million, respectively. The net receivable from parent

ACCREDITED MORTGAGE LOAN REIT TRUST

NOTES TO UNAUDITED FINANCIAL STATEMENTS

results from advances of excess cash holdings by the REIT to AHL. We expect the net receivable will be reduced at the time the REIT pays common stock dividends to AHL. Pursuant to the right of offset under the agreement between the parties, the net receivable will accrue interest at an annual rate equal to the six-month LIBOR plus 1.0%.

11. SUPPLEMENTAL CASH FLOW INFORMATION

The following represents supplemental cash flow information:

	Six Months Ended	
	2007	2006
	June 30,	
	(in thousands)	
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the period for interest	\$ 207,484	\$ 148,875
SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Transfer of loans held for investment to real estate owned, net of reserves	\$ 92,863	\$ 20,439
Detail of assets and liabilities contributed from parent:		
Mortgage loans, net of reserves	\$ 752,013	\$ 2,029,985
Other net liabilities	(10,504)	(25,612)
Outstanding balances on warehouse credit facilities	(745,267)	(2,012,768)
Liabilities in excess of assets contributed	\$ (3,758)	\$ (8,395)

12. COMMITMENTS AND CONTINGENCIES

In September 2007, the REIT was served with the consolidated, amended complaint in *Atlas v. Accredited Home Lenders Holding Co., et al.*, a class action pending in the United States District Court for the Southern District of California. The suit alleges violations of federal securities laws and originally named as defendants AHLHC and certain members of its senior management. Pursuant to the Private Securities Litigation Reform Act, five similar class actions were consolidated with the *Atlas* matter, and a lead plaintiff was selected. The consolidated, amended complaint was filed on August 24, 2007, and added as defendants the REIT and certain directors of AHLHC. The REIT's response to this complaint is currently scheduled to be due October 26, 2007. 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 the REIT intends 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, and legal counsel cannot express an opinion as to the extent of the REIT's possible loss, if any, in the consolidated lawsuit. However, the REIT believes any loss in this matter will be substantially or completely covered by insurance and that this matter will not have a material adverse effect on the REIT's financial position or results of operations.

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

13. SUBSEQUENT EVENTS

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

ACCREDITED MORTGAGE LOAN REIT TRUST

NOTES TO UNAUDITED FINANCIAL STATEMENTS

On July 23, 2007 the Panel determined to continue listing Accredited's common stock provided that Accredited filed with the SEC its 10-K by September 12, 2007 and its 10-Q for the first quarter of 2007 by September 18, 2007. The 10-K was filed with the SEC on August 2, 2007, and the 10-Q for the first quarter of 2007 was filed on September 18, 2007. On October 1, 2007 the Panel determined to continue listing Accredited's common stock provided that it files with the SEC its 10-Q for the second quarter of 2007 by November 1, 2007. As a result of the Lone Star merger, Accredited's common stock is 100% owned by Lone Star and is no longer publicly traded, and Accredited's common stock has been delisted from NASDAQ.

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 was 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 would be converted into the same \$15.10 cash per share price paid in the tender offer. On September 18, 2007 the merger agreement was amended to, among other things, reduce the acquisition price to \$11.75 per share, and the acquisition was completed at that price on October 12, 2007. The outstanding 9.75% Series A Preferred Shares, par value \$1.00 per share, of the REIT remained outstanding following the consummation of the acquisition.

Beginning in September 2007, AHL implemented a restructuring that included 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. The cost of this restructure including lease costs, fixed asset impairment and personnel costs is estimated at approximately \$35 million. This charge will be recorded in the third quarter of 2007.

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

On October 10, 2007, Accredited received a letter from the lender under the Farallon Loan in which the lender stated that it was exercising its option under the change of control provisions of the Loan Agreement to demand prepayment of the entire \$230 million loan amount, which \$100 million is owed by the REIT, plus the 2% change of control premium provided for under the Loan Agreement. Accredited and the REIT expects to repay all amounts due under the loan by the 30th business day following the date of the Farallon demand letter from available working capital, by financing certain assets currently securing the Farallon Loan, and with additional amounts to be contributed by Lone Star.

On October 12, 2007, Accredited received a \$100 million capital contribution from its new parent, LSF5 Accredited Investments, LLC, a subsidiary of Lone Star Fund V (U.S.) L.P.

On October 15, 2007, AHL resumed U.S. lending operations.

On October 19, 2007, Accredited and the REIT announced their intention to deregister the Series A Preferred Shares and Accredited's guarantee with respect to those shares. As a prerequisite to such deregistration, the REIT requested the New York Stock Exchange (NYSE) to delist the Series A Preferred Shares from the NYSE and anticipates filing Form 15 with the Securities and Exchange Commission by November 8, 2007, at which time the public reporting obligations of Accredited and the REIT will be suspended.

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

The following discussion should be reviewed in conjunction with our consolidated financial statements and the related notes and other financial information appearing elsewhere in this report. In addition to historical information, the following discussion and other parts of this document contain forward-looking information that involves risks and uncertainties. Please refer to the section entitled "Forward-Looking Statements" on page 1 of this Form 10-Q. Our actual results could differ materially from those anticipated by such forward-looking information due to factors discussed under the section entitled "ITEM 1A. Risk Factors" and elsewhere in this report.

General

In response to the ongoing turmoil in the non-prime mortgage industry, beginning in September 2007, we restructured our operations by closing our retail lending operations, substantially reducing our wholesale lending operations, laying off approximately 60% of our workforce and substantially suspending U.S. mortgage loan originations. On October 15, 2007, we resumed U.S. lending operations.

We are in the business of originating, financing, securitizing, servicing and selling non-prime mortgage loans secured by residential real estate throughout the United States, and, to a lesser extent, in Canada. We conduct business in both the wholesale channel (funding loans to borrowers through independent mortgage brokers) and, to a lesser extent, the retail channel (funding loans directly to borrowers). We focus on borrowers who do 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. We sell our mortgage loans in mortgage loan sales or we hold our mortgage loans in portfolio for investment and finance them with securitized bond financing.

Effective as of October 1, 2006, we acquired Aames Investment Corporation ("Aames") pursuant to an Agreement and Plan of Merger dated as of May 24, 2006. Aames, formerly a public REIT, managed a portfolio of nonprime residential mortgage loans and through its principal subsidiary originated, sold, and serviced residential mortgage loans through both wholesale and retail channels.

In July 2004, we formed Accredited Home Lenders Canada, Inc. ("AHLC"), as a wholly owned Canadian subsidiary and funded our first Canadian mortgage loan in November 2004. AHLC is a mortgage banking company that originates and finances mortgage loans for Canadian borrowers who are not normally eligible for traditional prime mortgages from the major Canadian banks. AHLC is currently originating mortgage loans in the provinces of Alberta, British Columbia, Manitoba, Ontario and Quebec and has current plans to expand beyond those five provinces.

In May 2004, we formed a Maryland real estate investment trust, Accredited Mortgage Loan REIT Trust (the "REIT"), 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., which in turn is a wholly owned subsidiary of Accredited Home Lenders Holding Co. 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 it timely distributes its taxable income to its shareholders and satisfies the real estate investment trust requirements and meets certain asset, income and share ownership tests.

Lone Star acquisition of Accredited

On June 4, 2007 we entered into an Agreement and Plan of Merger with affiliates of Lone Star Fund V (U.S.) L.P. ("Lone Star") pursuant to which Lone Star agreed to acquire all of the common stock of the Company in an all-cash transaction. Under the terms of the agreement, Lone Star agreed to acquire each outstanding share of Accredited common stock at a price of \$15.10 per share, for a total consideration of approximately \$400 million on a fully diluted basis. On September 18, 2007 the merger agreement was amended to, among other things, reduce the acquisition price to \$11.75 per share, and the acquisition was completed at that price on October 12, 2007. The outstanding 9.75% Series A Perpetual Cumulative Preferred Shares, par value \$1.00 per share, of Accredited Mortgage Loan REIT Trust (NYSE:AHH-PA) remained outstanding after the consummation of the acquisition.

In addition, on September 19, 2007, pursuant to the September 18, 2007 amendment of the merger agreement with Lone Star, Lone Star assumed the lender's obligations under AHL's Senior Secured Credit Agreement secured by mortgage servicing rights and servicing advances related to Accredited's securitizations. Lone Star agreed to remove the \$34 million cap under that facility and funded the facility up to \$49 million, providing approximately \$15 million of additional liquidity for the Company.

Recent Developments

Non-Prime Mortgage Market

In the third quarter of 2006, the non-prime mortgage market in which the Company operates was characterized by increased competition for loans and customers which simultaneously lowered profit margins on loans and caused lenders to be more aggressive in making loans to relatively less qualified customers. By the end of 2006, the non-prime mortgage industry was clearly being negatively impacted. The sustained pricing competition and higher risk portfolios of loans reduced the appetite for loans among whole loan buyers, who offered increasingly lower prices for loans, thereby shrinking profit margins for non-prime lenders. In addition, the higher levels of credit risk taken on by non-prime lenders resulted in higher rates of delinquency in the loans held for investment and in increasing frequency of early payment defaults and repurchase demands on loans that had been sold. These trends accelerated during the first quarter of 2007, and the industry experienced a period of turmoil which has continued into the second and third quarters of 2007. As of August 31, 2007, more than 100 mortgage companies operating in the non-prime mortgage industry had failed and many others faced serious operating and financial challenges. The most notable of these failures is New Century Mortgage Corporation (New Century), one of the largest non-prime originators in recent years, which filed for bankruptcy protection in April 2007.

It now appears that an underlying reason for the deterioration of industry conditions was the relatively poor performance of loans originated in 2006 in comparison to loans originated in 2004 and 2005. While real estate markets were booming during 2004 and 2005, and some areas experienced significant home price appreciation, many originators extended credit and underwriting standards to meet market demands. When home price appreciation leveled off, or in some areas declined, many of the loans originated in 2006 did not perform up to expectations. This decline in performance led to increases in the cost of securitizing non-prime loans as the rating agencies which rate non-prime securitizations increased loss coverage levels, requiring higher credit support for non-prime securitizations.

2007 Mortgage Market Significant Events

During 2007, a number of significant industry events occurred, including the following:

New Century announced that it would restate results for the nine months ended September 30, 2006 to account for losses on defaulted loans that it was obligated to repurchase (February 7th);

HSBC Holdings PLC, one of the world's largest banks and non-prime lenders, announced an increase in its bad debt charge for 2006, which it attributed to problems in its U.S. non-prime mortgage lending division (February 8th);

Credit-Based Asset Servicing and Securitization LLC (C-BASS) and Fieldstone Investment Corporation (Fieldstone) announced that they had entered into a definitive merger agreement under which C-BASS would acquire all of Fieldstone's outstanding common stock (February 16th);

ACC Capital Holdings, the parent company of Ameriquest Mortgage Company and Argent Mortgage Company, two large non-prime mortgage originators, announced that it had secured additional capital from Citi's Markets and Banking Division and its majority shareholder, and that Citi had agreed to become the company's primary warehouse lender and had acquired an option to buy the company's wholesale mortgage business (February 28th);

Fremont General Corp. (Fremont), another significant non-prime mortgage originator, announced that it would exit its non-prime real estate lending operations and that it was in discussions with various parties regarding the sale of this business (March 2nd);

The New York Stock Exchange suspended trading of New Century's common stock based on uncertainties concerning its liquidity position (March 12th);

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Fieldstone announced that it had amended its previously announced merger agreement with C-BASS to reduce the price of Fieldstone's common stock to \$4.00 per share (March 16th);

People's Choice Home Loan, Inc., another significant non-prime mortgage originator, filed for bankruptcy protection (March 20th);

Fremont sold approximately \$4.0 billion of non-prime residential real estate loans and entered into exclusive negotiations with the same institution to sell most of its residential real estate business (March 21st);

New Century filed for bankruptcy protection (April 2nd);

NovaStar Financial, another significant non-prime mortgage originator, initiated a formal process to explore strategic alternatives and received \$100 million in financing (April 11th);

First Horizon National Corp. blamed difficulty selling mortgages in the secondary market and increased repurchase requests for its decision to shutter its subprime business (April 20th);

H&R Block Inc. announced the sale of Option One Mortgage Corp. (Option One), another large non-prime mortgage originator, to an affiliate of Cerberus Capital Management with a transaction value equal to Option One 's tangible net assets as of the date of closing less \$300 million (April 20th);

WMC, a unit of General Electric Co., announced that it would cut 771 jobs (April 20th);

Standard & Poor 's Ratings Service placed its credit ratings on 612 classes of residential mortgage-backed securities backed by U.S. non-prime collateral on credit watch with negative implications because of poor collateral performance, expectation of increasing losses on the underlying collateral pools, the consequent reduction of credit support, and changes that will be implemented with respect to the methodology for rating new transactions (July 10th);

Moody 's Investors Service downgraded 399 residential mortgage-backed securities and placed an additional 32 residential mortgage-backed securities under review for possible downgrade based on higher than anticipated rates of delinquency in the underlying collateral compared to current credit enhancement levels (July 10th);

General Electric Co. announced plans to sell WMC Mortgage Corp, its three-year-old U.S. non-prime mortgage unit (July 12th);

NovaStar Financial, Inc. announced an investment of \$48.8 million by MassMutual and Jefferies Capital Partners as part of a commitment to raise \$150 million in new equity to complete its formal process of exploring strategic alternatives (July 16th);

Bear Stearns announced the collapse of two of its hedge funds that had invested in non-prime mortgage securities (July 18th);

Countrywide Financial Corp. 's second-quarter net income fell 33% because of softening home prices. Countrywide cut its 2007 earnings estimate because it expects a challenging second half, including difficulty in the housing and mortgage markets (July 24th);

American Home Mortgage Investment Corp. announced a delayed payment of its quarterly cash dividend on the company 's common stock and anticipated delaying payment of its quarterly cash dividends on its preferred stock in order to preserve liquidity until it obtains a better understanding of the impact that current market conditions in the mortgage industry and the broader credit market will have on the company 's balance sheet and overall liquidity. American Home Mortgage said that the unprecedented disruption in the credit markets in the past few weeks caused major write-downs of its loan and security portfolios and consequently has caused significant margin calls with respect to its credit facilities (July 28th);

MGIC Investment Corporation announced that it had concluded that the value of its investment in C-BASS had been materially impaired because the market for non-prime mortgages had experienced significant turmoil beginning in February 2007, with market dislocations accelerating to unprecedented levels beginning in approximately mid-July 2007 (July 30th);

American Home Mortgage announced that it was unable to borrow on its credit facilities and to fund its lending obligations of approximately \$300 million on July 30 and that it did not anticipate funding approximately \$450 to \$500 million on July 31 (July 31th);

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American Home Mortgage filed for bankruptcy protection (August 6th);

Aegis Mortgage suspended loan originations (August 6th) and filed for bankruptcy protection (August 10th);

HomeBanc filed for bankruptcy protection (August 10th);

NovaStar Financial suspended wholesale originations (August 17th) and sharply reduced retail originations (September 4th);

Countrywide Financial Corp., facing unprecedented disruptions to its funding operations, tapped an \$11.5 billion credit line (August 16th); Bank of America invested \$2 billion in Countrywide (August 22th);

Capital One shut down its GreenPoint Mortgage subsidiary, cutting 1,900 jobs (August 20th);

Lehman Brothers announced the closing of its subprime subsidiary, BNC Mortgage LLC (August 22th);

Countrywide Financial Corp. announced plan to reduce its workforce by 20% or 12,000 over the next three months, expected total mortgage market originations to decline by 25% in 2008 and discontinued originating subprime mortgage loans (September 7th);

Nationstar Mortgage, the subprime unit of Fortress Investment Group, stopped all wholesale originations (September 21st);

HSBC closed one of its non-prime lending units, Decision One (September 24th);

Luminant Mortgage Capital Inc. stated that the fallout from the subprime mortgage crisis could cut the value of its investment portfolio and may lead to the loss of its real-estate investment trust status (September 26th);

Credit Suisse Group began pruning its mortgage-backed securities unit by laying off 150 employees (September 26th);

Morgan Stanley cut 600 positions related to its mortgage business (October 2nd); and

Bear Stearns cut 310 jobs by combining two of its mortgage units (October 3rd).

The events outlined above chronicle the distress in the mortgage industry in 2007. One of the results of the contraction in the industry was a significant increase in the amount of distressed loans for sale in the market. This increase in loan supply and decrease in loan demand substantially reduced whole loan prices for most of 2007, providing a basis for warehouse line providers to mark down the collateral value of loans held in inventory and, as a result, to place margin calls on non-prime lenders. These increased margin calls resulted in more distressed sales which, in turn, put further downward pressure on whole loan sale prices, regenerating the cycle with escalating negative results.

2007 Mortgage Markets Response by Accredited

Strategic Restructurings

We require substantial cash to fund our mortgage loan originations, to pay our mortgage loan origination expenses and to hold our mortgage loans pending sale or securitization. Also, as a servicer of mortgage loans, we are required to advance delinquent principal and interest payments, unpaid property taxes, hazard insurance premiums, and foreclosure and foreclosure-related costs. While we maintain warehouse and other credit facilities that provide substantial financing for our operations, we must originate mortgage loans and sell or securitize our mortgage loan originations at a profit in order to maintain our credit facilities and successfully fund our operations over time.

Due to the turbulence in the non-prime mortgage industry, we have not been able to sell or securitize at a profit most of the mortgage loans we have originated throughout 2007. Accordingly, beginning in September 2007, we implemented a restructuring that includes the closing of all retail lending operations, significantly downsizing of our wholesale lending operations, and substantially suspending all U.S. mortgage loan originations unless and until the return of market conditions under which non-prime mortgage loans could 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, the settlement services division, and reduced the workforce by 1,600 employees to approximately 1,000 at September 14, 2007. The cost of the restructure, including lease costs, fixed asset impairment and personnel costs, is estimated at approximately \$35 million. The charge will be recorded in the third quarter of 2007.

On October 15, 2007, we resumed U.S. lending operations because we believe that, with the support of our new parent, Lone Star, we can resume lending operations in a manner that will be beneficial over the long term. There can, however, be no assurance that our resumption of U.S. lending operations will be successful or that our other sources of income— income derived from our servicing operations, our residual interests in previously securitized loans and our Canadian mortgage loan originations— will be sufficient to fund our operations going forward.

Funding and Liquidity Transactions

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

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On March 30, 2007, the Company amended the Amended and Restated Master Repurchase Agreement, dated as of December 30, 2005, with Credit Suisse First Boston Mortgage Capital LLC (CSFB), and, on March 29, 2007, 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 28, 2008, and the maximum committed amount available for borrowing remained at \$600 million. Under the agreement with Wachovia, as subsequently amended on May 1, 2007 and on July 5, 2007, the term of the Wachovia repurchase facility was extended through March 25, 2008, and the maximum committed amount available for borrowing was increased to \$1 billion.

Also on March 30, 2007, the Company and certain of its subsidiaries entered into a secured 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. 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 repaid 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 repaid.

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

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

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

On August 17, 2007, the Company entered into a transaction which for legal purposes is treated as a sale but is treated as a financing for accounting purposes. The transaction includes a call provision exercisable by the Company which results in the transaction failing to qualify for sale treatment in accordance with the provisions of SFAS 140. The Company has agreed to trade approximately \$1 billion of loans at an advance rate of 92.25% of the original principal balance of the mortgage loans traded, which is comparable to the advance rates the Company was then receiving from its 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. As of October 16, 2007, \$976 million of the original pool had been settled, with the final settlement of loans expected to occur by the end of October 2007. Under the agreement, the Company 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 of approximately 3% of the original principal balance of the mortgage loans traded or approximately \$30 million. If we do not reacquire the loans by mid-November, the call premium will not be paid and 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.

On October 10, 2007, we received a letter from the lender under the Farallon Loan in which the lender stated that it was exercising its option under the change of control provisions of the Loan Agreement to demand payment, by the 30th business day following our receipt of the letter, of the entire \$230 million outstanding balance of the loan, accrued interest thereon and the 2% change of control premium provided for under the Loan Agreement. We expect to repay all amounts due under the loan when due from available working capital, by financing certain assets currently securing the Farallon Loan, and with additional amounts contributed by Lone Star.

On October 12, 2007, the Company received a \$100 million capital contribution from our new parent, LSF5 Accredited Investments, LLC, a subsidiary of Lone Star Fund V (U.S.) L.P.

On October 15, 2007, we resumed U.S. lending operations.

Increased Repurchase Activity

We have seen delinquencies and defaults, including early payment defaults, increased substantially in our 2006 mortgage originations as compared to prior mortgage originations. In 2007, these credit issues caused increases in loans repurchased from investors from prior whole loan sales and higher loss provisions on mortgage loans held in portfolio. In addition, the number of mortgage loans we have repurchased has increased as a result of our merger with Aames, since we assumed their repurchase obligations upon the closing of the merger. In late 2006 continuing into 2007, certain investors became more aggressive regarding the identification and pursuit of repurchase claims against the Company. During the nine

months ended September 30, 2007, we repurchased approximately \$208 million in mortgage loans and paid \$67 million in cash settlements to resolve repurchase claims and, in some cases, eliminate the requirement to repurchase mortgage loans in the future from certain investors.

Other 2007 Events and Transactions

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

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

NASDAQ Delisting

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 31, 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 and our 10-Q for the first quarter of 2007 on September 18, 2007. On October 1, 2007 the Panel determined to continue listing our common stock provided that we file with the SEC our 10-Q for the second quarter of 2007 by November 1, 2007. As a result of the Lone Star merger, our common stock is 100% owned by Lone Star and is no longer publicly traded, and our common stock has been delisted from NASDAQ.

NYSE Delisting

On October 19, 2007, Accredited and the REIT announced their intention to deregister the Series A Preferred Shares and Accredited's guarantee with respect to those shares, on the basis that the shares are currently held by less than 300 registered holders, and, as a prerequisite to such deregistration, the REIT requested the New York Stock Exchange (NYSE) to delist the Series A Preferred Shares from the NYSE. The NYSE has ten days following such request in which to make the filing with the Securities and Exchange Commission (the SEC) that begins the delisting process, and delisting is effective ten days following such filing. At that time, the filings which begin the deregistration process can be made with the SEC. The deregistration filings are expected to be made by November 8, 2007, at which time the public reporting obligations of Accredited and the REIT will be suspended. The terms and conditions of the Series A Preferred Shares and Accredited's related guarantee will remain unchanged following any delisting of the shares and any deregistration of the shares and the related guarantee. However, if the Series A Preferred Shares are delisted from the NYSE, there may be a material adverse impact on the market price and liquidity of our Preferred Shares, and our Preferred Shares may be subject to the penny stock rules contained in Section 15(g) of the Securities Exchange Act of 1934, as amended, and the rules promulgated thereunder. Also, if the Series A Preferred Share and the related guarantee are deregistered under the 34 Act, holders of the shares may not have access to the same quantity and quality of information regarding Accredited and the REIT as they would have if the shares and the guarantee remained registered.

Class Action Lawsuits

In 2007, several class action lawsuits were filed against the Company and certain of its officers and directors. Certain of the lawsuits generally allege that, between November 1, 2005 and March 12, 2007, we issued materially false and misleading statements regarding our business and financial results causing the Company's stock to trade at artificially inflated prices. Other complaints allege breaches of fiduciary duty by the Company and members of its Board of Directors in connection with the Company's entry into an Agreement and Plan of Merger with affiliates of Lone Star Fund V (U.S.) L.P. This latter lawsuit has been resolved, and the Company believes that the other lawsuits have no merit and intends to continue to vigorously defend the cases. For additional information, see Note 14 in the Notes to Unaudited Consolidated Financial Statements.

Securitized \$760 million of non-prime loans

We closed a securitization transaction involving \$760 million of non-prime loans on January 30, 2007.

Issuance of Trust Preferred Securities

On January 11, 2007, we completed a \$56 million private placement of trust preferred securities through our subsidiary, Accredited Preferred Securities Trust I. The trust preferred securities bear interest at a fixed rate of 9.01% until January 30, 2012, whereupon the rate floats at three-month LIBOR plus 3.95% thereafter until their maturity in January 2037, unless earlier redeemed. The trust preferred securities can be redeemed in whole or in part by Accredited beginning January 30, 2012 without penalty.

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

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

Revenue Model

Our operations generate revenues in three ways:

Interest income. We have two primary components to our interest income. We generate interest income over the life of the mortgage loan on the loans we have securitized in structures that require financing treatment. This interest is partially offset by the interest we pay on the bonds that we issue to fund these mortgage loans. We also generate interest income on mortgage loans held for sale and for securitization from the time we originate the mortgage loan until the time we sell or securitize the mortgage loan. This interest income is partially offset by our borrowing costs under our warehouse credit facilities used to finance these mortgage loans.

Gain on sale of mortgage loans. We generate gain on sale of mortgage loans by selling the mortgage loans we originate for a premium. However, due to the turmoil in the non-prime mortgage market, most mortgage loans originated in 2007 have been sold at a loss or discount to par.

Mortgage loan servicing income. Our mortgage loan servicing income represents all contractual and ancillary servicing revenue for mortgage loans that Accredited services for others, net of servicing costs and amortization of mortgage servicing rights.

Our revenues also include:

Provisions for losses on mortgage loans held for investment (which reduce net interest income)

Valuation adjustments for mortgage loans held for sale

Provisions for losses on repurchases and premium recapture on mortgage loans sold (which reduce gain on sale premiums)

Net gains or losses on derivatives on our mortgage loans held for sale, and derivatives on certain of our mortgage loans held for investment, which reflect changes in the value of these instruments based on market conditions

We generate a significant portion of our revenue and cash flows from net interest income on securitizations. Our securitization transactions are legally structured as sales, but for accounting purposes are structured as financings. Accordingly, the mortgage loans remain on our balance sheet, retained interests are not created, and debt securities issued in the securitization replace the warehouse debt originally associated with the securitized mortgage loans. We record interest income on the mortgage loans and interest expense on the debt securities, as well as recognize ancillary fees and provision for loan losses over the life of the securitization, instead of recognizing a gain or loss upon the closing of the securitization transactions. This portfolio-based accounting closely matches the recognition of income with the actual receipt of cash payments.

We anticipate that our results of operations will fluctuate on a quarterly and annual basis. The timing and degree of fluctuation will depend upon several factors, including the resumption of our mortgage loan originations, competition, economic slowdowns and increased interest rates, in addition to those discussed under Risk Factors.

Results of Operations

Three Months Ended June 30, 2007 Compared to the Three Months Ended June 30, 2006

Executive Summary

We recorded a net loss of \$76.9 million for the three months ended June 30, 2007, or \$3.03 per diluted share, compared to net income of \$41.3 million, or \$1.84 per diluted share for the three months ended June 30, 2006. This net loss was the result of the following:

Mortgage loan origination volume dropped 59%, from \$4.1 billion for the three months ended June 30, 2006 to \$1.7 billion for the same period in 2007. Production was negatively impacted by adverse secondary market conditions and continued restrictions of our product menu and underwriting guidelines.

Net interest income before provision for loan losses declined by \$37.0 million or 47.3%, from \$78.1 million for the three months ended June 30, 2006 to \$41.1 million for the same period in 2007, due to a reduction in loans held for sale, higher levels of non-performing loans and an increasing cost of funds.

The provision for losses on mortgage loans held for investment increased \$19.1 million or 146.1% from \$13.1 million for the three months ended June 30, 2006 to \$32.1 million for the same period in 2007. The increase in the provision was due to the \$58.4 million increase in the level of real estate owned (REO) during the second quarter of 2007 compared to the \$18.4 million increase in REO during the second quarter of 2006 and an increase in the estimated loss severity rate on REO assets.

We sold \$1.2 billion in mortgage loans during the three months ended June 30, 2007 at a gain on sale price (including hedge gains) of 1.62% compared to sales during the same period in 2006 of \$3.7 billion at a gain on sale price (including hedge gains) of 2.51%. Net gain on sale dropped \$73.2 million or 79.3% from \$92.3 million for the three months ended June 30, 2006 to \$19.1 million for the same period in 2007. This significant decline was primarily caused by the adverse conditions in the non-prime mortgage market which resulted in lower mortgage origination volume and substantially lower mortgage loan sales.

The provision for market valuation losses on loans held for sale increased \$19.0 million, from \$15.6 million for the three months ended June 30, 2006 to \$34.6 million for the same period in 2007. This provision increase was the result of increasing delinquencies in loans originated and repurchased that remained in loans held for sale at June 30, 2007, coupled with a sharp decline in secondary market prices for delinquent first and second lien non-prime mortgage loans.

Repurchase loan activity increased significantly in 2007. We repurchased \$105.2 million in mortgage loans from investors in the three months ended June 30, 2007 and transferred the repurchased loans to loans held for sale inventory, which caused a portion of the increase in the provision for market valuation losses for the three months ended June 30, 2007.

Operating expenses increased \$7.8 million or 9.6%, from \$81.2 million for the three months ended June 30, 2006 to \$88.9 million for the same period in 2007, primarily due to an increase in legal and investment banking fees and additional occupancy expenses from the Aames operation acquired in the fourth quarter of 2006.

The provision for income taxes was \$5.2 million for the three months ended June 30, 2007 and was attributable to profits from our Canadian operations and minimum federal and state income taxes, as we could not record a tax benefit resulting from the operating loss due to limitations on net operating loss carryforwards.

Net cost to originate, a key measure of our efficiency in originating mortgage loans, increased significantly from 1.34% for the three months ended June 30, 2006 to 3.38% for the same period in 2007 driven primarily by the sharp decline in origination volume for the three months ended June 30, 2007.

Net Revenues

Net revenues and key indicators that affect our net revenues are as follows for the three months ended June 30:

	2007	2006	Change	% Change
	(dollars in thousands)			
Interest income (1)	\$ 158,099	\$ 205,050	\$ (46,951)	(22.9)%
Interest expense (2)	(116,990)	(126,976)	9,986	(7.9)%
Net interest income	41,109	78,074	(36,965)	(47.3)%
Provision for losses on mortgage loans held for investment	(32,146)	(13,062)	(19,084)	146.1%
Net interest income after provision	8,963	65,012	(56,049)	(86.2)%
Gain (loss) on sale of mortgage loans	(1,557)	80,673	(82,230)	(101.9)%
Mortgage loan servicing income	4,819	4,032	787	19.5%
Other income	7,476	3,450	4,026	116.7%
Total net revenues	\$ 19,701	\$ 153,167	\$ (133,466)	(87.1)%
Mortgage loan originations	\$ 1,676,618	\$ 4,079,195	\$ (2,402,577)	(58.9)%
Mortgage loan sales	\$ 1,177,800	\$ 3,674,723	\$ (2,496,923)	(67.9)%
Mortgage loans securitized	\$	\$ 1,050,076	\$ (1,050,076)	(100.0)%
Average inventory of mortgage loans	\$ 8,535,631	\$ 10,308,868	\$ (1,773,237)	(17.2)%
	7.41%	7.96%		

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Annualized interest income as a percentage of average inventory of mortgage loans

Average outstanding borrowings	\$ 8,299,546	\$ 9,943,626	\$ (1,644,080)	(16.5)%
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(1) Interest income includes prepayment penalty income and gains and losses from hedging activities.

(2) Interest expense includes gains and losses from hedging activities and amortization of debt issuance costs.

Interest Spread on Mortgage Loans Held for Sale

Interest income on mortgage loans held for sale decreased \$55.6 million or 77.6%, from \$71.6 million for the three months ended June 30, 2006 to \$16.1 million for the same period in 2007. This was reflective of a 48 basis point decrease in the average interest rate on mortgage loans held for sale, from 8.10% in the second quarter of 2006 to 7.62% in the second

quarter of 2007 and a \$2.7 billion decrease in the average portfolio of loans held for sale from \$3.5 billion in the second quarter of 2006 to \$844 million in second quarter of 2007. We increased the interest rates charged on new loans to borrowers by 36 basis points from the second quarter of 2006 to the second quarter of 2007, but the yield was reduced 84 basis points due to increases in non-performing loans, resulting in a net decrease in the average rate of 48 basis points. The average balance of non-performing mortgage loans held for sale increased from \$67.8 million in the second quarter of 2006 to \$98.1 million in the second quarter of 2007 as the rate of delinquencies and the level of repurchased loans increased. The \$2.7 billion decrease in the average portfolio of loans held for sale was the result of the 59% decline in mortgage loan originations from the second quarter of 2006 to the second quarter of 2007.

Interest expense on mortgage loans held for sale decreased \$34.8 million or 76.6% from \$45.5 million for the three months ended June 30, 2006 to \$10.6 million for the same period in 2007. This decrease resulted from a \$2.5 billion decrease in our average warehouse borrowings, including the ABCP facility, from \$3.2 billion in the second quarter of 2006 to \$742 million in the second quarter of 2007 as our cost of funds remained stable at 5.67% for the three months ended June 30, 2007 compared 5.63% for the three months ended June 30, 2006. The amortization of commitment fees paid to warehouse lenders increased \$1.4 million in the second quarter of 2007 due to our termination of certain warehouse agreements and the ABCP facility, and represented 154 basis points of our average warehouse borrowings during the period compared to 19 basis points in the same period of 2006.

For the three months ended June 30, 2007, the resulting interest spread on our portfolio of mortgage loans held for sale declined \$22.1 million or 187 basis points, from 2.28% in 2006 to .41% in 2007, as interest expense, including commitment fees, decreased \$33.5 million or 139 basis points while interest income decreased \$55.6 million or 48 basis points.

Interest Spread on Mortgage Loans Held for Investment

Interest income on mortgage loans held for investment increased \$11.8 million or 9.8%, from \$120.1 million for the three months ended June 30, 2006 to \$131.9 million for the same period in 2007. This increase was primarily the result of a \$920 million or 13.6% increase in the average portfolio of loans held for investment from \$6.8 billion in the second quarter of 2006 to \$7.7 billion in the second quarter of 2007, as we continued to execute our securitization program and added securitized loans acquired from Aames. The interest rate on loans held for investment decreased 23 basis points, from 7.09% for the three months ended June 30, 2006 to 6.86% for the same period in 2007 as the average balance of non-performing loans increased from \$134.5 million for the three months ended June 30, 2006 to \$527.7 million for the same period in 2007. Prepayment penalty fees received and other income declined by \$3.2 million from \$13.4 million for the three months ended June 30, 2006 to \$10.2 million for the same period in 2007 as loan prepayments began to slow due to falling home prices and tighter credit conditions. The \$920 million increase in the average portfolio of loans held for investment during the second quarter of 2007 was caused by the addition of \$1.1 billion in securitized loans during the twelve months ended June 30, 2007 and the \$1.1 billion in securitized loans acquired from Aames held during the second quarter of 2007, less normal portfolio run-off due to principal repayments.

Interest expense on mortgage loans held for investment increased \$13.4 million or 15.4% from \$86.8 million for the three months ended June 30, 2006 to \$100.2 million for the same period in 2007. This increase was primarily the result of the \$829 million or 12.3% increase in our average securitized bond financing from \$6.7 billion in the second quarter of 2006 to \$7.6 billion in the second quarter of 2007 plus a 14 basis point increase in our cost of funds rate, from 5.11% in the second quarter of 2006 to 5.25% in the second quarter of 2007. The 14 basis point rate increase in our cost of funds was caused by the increase in the average One Month LIBOR rate. The \$829 million increase in the average securitized bond financing was the result of the addition of \$1.1 billion in securitized bonds during the twelve months ended June 30, 2007 and the \$1.1 billion in securitized bonds acquired from Aames and held during the second quarter of 2007, less normal bond amortization.

The resulting interest spread declined \$5.8 million from \$53.4 million for the three months ended June 30, 2006 to \$47.7 million for the same period in 2007, and the interest margin declined 73 basis points, from 3.08% in 2006 to 2.35% in 2007.

Interest expense on other term debt was \$9.1 million for the three months ended June 30, 2007 and represented interest on (1) the \$56 million in trust preferred securities at 9.01%, (2) the \$230 million Farallon loan at 13% plus discount amortization of 1.2% and (3) the revolving balances outstanding during the quarter on the senior credit facility secured by mortgage servicing rights and servicing advances.

The components of our net interest income were as follows for the three months ended June 30:

	2007			2006		
	Interest	Average		Interest	Average	
	Income	Balance	Average	Income	Balance	Average
	(Expense)	Outstanding	Rate	(Expense)	Outstanding	Rate
	(dollars in thousands)					
Mortgage loans held for sale (1):						
Interest income	\$ 16,071	\$ 843,950	7.62%	\$ 71,629	\$ 3,537,011	8.10%
Interest expense	(10,638)	741,580	(5.67)	(45,478)	3,215,315	(5.63)
Commitment fee expense	(2,887)		(1.54)	(1,519)		(0.19)
Spread	2,546		0.41	24,632		2.28
Mortgage loans held for investment:						
Interest income	131,875	7,691,681	6.86	120,065	6,771,857	7.09
Prepayment penalty and other income	10,153		0.53	13,356		0.79
Interest expense	(100,222)	7,557,966	(5.25)	(86,819)	6,728,311	(5.11)
Hedging gains and bond issue cost amortization, net	5,853		0.31	6,840		0.41
Spread	47,659		2.45	53,442		3.18
Net interest margin	50,205	8,535,631	2.35	78,074	10,308,868	3.08
Other term debt:						
Interest expense gin	(9,096)	288,988	(12.59)			
Net interest income	\$ 41,109	\$ 8,535,631	1.93%	\$ 78,074	\$ 10,308,868	3.08%

(1) Includes mortgage loans held for sale and mortgage loans held for securitization.

Provisions and Reserves for Losses

We make provisions for losses on our portfolio of mortgage loans held for investment based upon our estimate of expected losses resulting from loans in various stages of delinquency, calculated using assumptions of loss frequency and loss severity.

We make market valuation provisions (LOCOM) for classes of loans within our portfolio of mortgage loans held for sale that are current, delinquent, aged or have documentation exceptions, when the current prices in the secondary market for mortgage loans with these characteristics are lower than our cost.

Certain 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 loan an early payment default. 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 from the date of sale. We estimate provisions for repurchase losses on mortgage loans sold in the secondary market based upon our estimate of the expected frequency of repurchase claims and a loss severity rate assumption.

The assumptions used in estimating losses are updated periodically based on our actual experience as well as current market trends.

The total provision for losses detailed below increased \$38.1 million or 116.6%, from \$32.7 million for the three months ended June 30, 2006 to \$70.7 million for the same period in 2007. This provision increase was driven by increasing delinquencies in our mortgage loan portfolio, declining prices for delinquent loans in the secondary market and an increase in the level of repurchase claims. Loans more than 30 days delinquent (excluding mortgage loans acquired from Aames) increased from 3.86% at June 30, 2006 to 9.47% at June 30, 2007. The primary reasons for the increase in 30+ day delinquencies were the aging of the portfolio, higher delinquencies from the late 2005 and 2006

securitizations and additional delinquencies from repurchased loans.

The combined provisions for mortgage loans held for investment and REO increased \$19.0 million or 146.1%, from \$13.1 million for the three months ended June 30, 2006 to \$32.1 million for the same period in 2007. The increase in the provision was due to the \$58.4 million increase in the level of REO (acquired in settlement of mortgage loans held for sale and mortgage loans held for investment) during the second quarter of 2007 compared to the \$18.4 million increase in REO in the second quarter of 2006 and an increase in the estimated loss severity rate on REO assets.

The provision for LOCOM on loans held for sale increased \$19.0 million, from \$15.6 million for the three months ended June 30, 2006 to \$34.6 million for the same period in 2007. This provision increase was the result of increasing delinquencies in loans originated and repurchased, coupled with a sharp decline in secondary market prices for delinquent first and second lien non-prime mortgage loans. The secondary market investors were especially punitive on second-lien non-prime mortgage loans and first lien non-prime mortgage loans with low credit scores, high loan-to-value ratios and stated income documentation in 2007. In response to these market factors, we continued to change our credit guidelines during the first and second quarters of 2007 and reduce our menu of loan programs to restrict the number of loans we originated with these characteristics, including first and second lien combo loans.

The provision for repurchase losses increased \$2.4 million in the three months ended June 30, 2007 compared to the same period in 2006. From late 2006 continuing into the second quarter of 2007, certain investors became more aggressive regarding the identification and pursuit of repurchase claims against the Company. During the three months ended June 30, 2007, we repurchased \$105.2 million in mortgage loans and paid \$7.8 million in cash settlements to resolve repurchase claims and, in some cases, eliminate the requirement to repurchase mortgage loans in the future from certain investors both of these actions reduced the repurchase reserve during the second quarter of 2007. At June 30, 2007, we had \$62.6 million in qualified repurchase claims and a reserve for losses on repurchase claims of \$45.7 million.

The total reserves for losses outlined below decreased \$19.0 million, from \$326.0 million at December 31, 2006 to \$307.0 million at June 30, 2007. In addition, the key ratio of loss reserves on mortgage loans held for investment to principal balance outstanding on mortgage loans held for investment increased from 1.84% at December 31, 2006 to 2.32% at June 30, 2007.

The total provision for losses and their related reserve balances were comprised of the following:

	2007	2006	Change	% Change
	(dollars in thousands)			
Provision for losses for the three months ended June 30:				
Mortgage loans held for investment	\$ 9,988	\$ 10,109	\$ (121)	(1.2)%
Real estate owned	22,158	2,953	19,205	650.4%
Provision for losses on mortgage loans held for investment				
LOCOM valuation	32,146	13,062	19,084	146.1%
Repurchases	34,596	15,611	18,985	121.6%
Premium recapture	4,296	1,864	2,432	130.5%
	(294)	2,125	(2,419)	(113.8)%
Total provision for losses	\$ 70,744	\$ 32,662	\$ 38,082	116.6%

	June 30,	December 31,	Change	% Change
	2007	2006	(dollars in thousands)	
Reserves for losses at period end:				
Mortgage loans held for investment (1)(2)	\$ 144,160	\$ 138,250	\$ 5,910	4.3%
Real estate owned (3)	73,905	40,364	33,541	83.1%
LOCOM valuation (4)	40,060	36,525	3,535	9.7%
Repurchases (5)	45,721	106,111	(60,390)	(56.9)%
Premium recapture (5)	3,126	4,798	(1,672)	(34.8)%
Total reserves for losses	\$ 306,972	\$ 326,048	\$ (19,076)	(5.9)%

Principal balance at period end (1):				
Mortgage loans held for investment	\$ 6,200,475	\$ 7,503,245	\$ (1,302,770)	(17.4)%

Reserve balance as a percentage of mortgage loans held for investment (6)	2.32%	1.84%
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- (1) The reserve for losses on mortgage loans held for investment in 2007 excludes reserves for losses on Aames mortgage loans due to the effect of purchase accounting. The principal balance of mortgage loans held for investment at June 30, 2007 also excludes any Aames related balances for consistency in presentation within this table.
- (2) Reserve for losses on mortgage loans held for investment is included in mortgage loans held for investment on the consolidated balance sheets.

- (3) Reserve for losses on real estate owned is included in real estate owned on the consolidated balance sheets.
- (4) Reserve for LOCOM valuation losses are included in loans held for sale on the consolidated balance sheets.
- (5) Reserves for repurchases and premium recapture are included in accrued expenses and other liabilities on the consolidated balance sheets.
- (6) The reserve balance percentages for mortgage loans held for investment are calculated by dividing the reserve for losses on mortgage loans held for investment by the principal balance of mortgage loans held for investment

Gain (Loss) on Sale of Mortgage Loans

We recorded a gross gain on sale of mortgage loans of \$14.6 million (\$19.1 million after derivative gains) on loan sales of \$1.2 billion for the three months ended June 30, 2007 compared to a gross gain on sale of mortgage loans of \$80.0 million (\$92.3 million after derivative gains) on loan sales of \$3.7 billion for the same period in 2006. These results translate into loans sold at a premium to par of 1.62% (101.62 sell price) for the three months ended June 30, 2007 compared to loans sold at a 2.51% premium to par (102.51% sell price) during the same period in 2006. The components of the gain (loss) on sale of mortgage loans were as follows for the three months ended June 30:

	2007	2006 (1)	Change	% Change
	(dollars in thousands)			
Gross gain on mortgage loan sales	\$ 14,645	\$ 79,991	\$ (65,346)	(81.7)%
Net gain on derivatives	4,466	12,317	(7,851)	(63.7)%
Net gain on sale of mortgage loans	19,111	92,308	(73,197)	(79.3)%
Provision for market valuation LOCOM	(34,596)	(15,611)	(18,985)	121.6%
Provision for loss on repurchases and premium recapture	(4,002)	(3,989)	(13)	0.3%
Net origination points and fees recognized on sale	21,431	20,757	674	3.2%
Direct mortgage loan origination expenses	(3,501)	(12,792)	9,291	(72.6)%
Total net gain (loss) on sale of mortgage loans (2)	\$ (1,557)	\$ 80,673	\$ (82,230)	(101.9)%
Whole loan sales (2)	\$ 1,177,800	\$ 3,674,723	\$ (2,496,923)	(67.9)%
Gain on sale rates (3):				
Gross gain on mortgage loan sales	1.24%	2.17%		
Net gain on derivatives	0.38%	0.34%		
Net gain on sale of mortgage loans	1.62%	2.51%		

- (1) Reclassified to conform to 2007 presentation.
- (2) In accordance with purchase accounting requirements, mortgage loans acquired from Aames were recorded at fair market value, therefore no significant gains or losses were recognized on the sale of mortgage loans acquired from Aames.
- (3) Gain on sale rates are calculated based on the respective amounts divided by whole loan sales, excluding Aames whole loan sales.

Operating Expenses

Operating expenses were as follows for the three months ended June 30:

	2007	2006	Change	% Change
	(dollars in thousands)			
Salaries, wages and benefits	\$ 49,452	\$ 49,274	\$ 178	0.4%
General and administrative	19,869	15,539	4,330	27.9%
Occupancy	10,013	6,338	3,675	58.0%
Advertising and promotion	4,376	5,306	(930)	(17.5)%
Depreciation and amortization	5,225	4,693	532	11.3%
Total operating expenses	\$ 88,935	\$ 81,150	\$ 7,785	9.6%

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Total serviced loans at period end	\$ 8,471,942	\$ 9,526,735	\$ (1,054,793)	(11.1)%
Total number of employees at period end	2,591	2,902	(311)	(10.7)%

Salaries, Wages and Benefits. Salaries, wages and benefits were \$49.5 million for the three months ended June 30, 2007 compared to \$49.3 million for the same period in 2006. Headcount steadily declined during the quarter, from 2,902 at April 1, 2007 to 2,591 at June 30, 2007 as we lost staff across all departments due to attrition. Average headcount was 2,737 during the three months ended June 30, 2007 compared to 2,688 during the same period in 2006. Commission and bonus expenses were off sharply in 2007 compared to 2006 but were offset by an equal reduction in compensation expense capitalized to loans held for sale under SFAS 91 as loans held for sale balances declined.

General and Administrative. General and administrative expenses increased \$4.3 million or 27.9% during the three months ended June 30, 2007 compared to the same period in 2006 due primarily to increases in legal and investment banking fees, including those associated with the merger with Lone Star and the defense against stockholder lawsuits.

Occupancy. Occupancy expenses increased \$3.7 million or 58.0% during the second quarter of 2007 primarily due to increased leasing costs associated with the additional Aames locations acquired in the merger.

Advertising and Promotion. Advertising and promotion expenses declined 17.5% during the three months ended June 30, 2007 as we reduced spending on referrals and leads for our retail division due to the decline in demand for retail mortgage loan originations.

Depreciation and Amortization. Depreciation and amortization increased 11.3% during the three months ended June 30, 2007 due primarily to additional investments in technology.

Net Cost to Originate

We monitor our net cost to originate mortgage loans, as we believe that it provides a measurement of efficiency in our mortgage loan origination process. The calculation of this net cost to originate was as follows for the three months ended June 30:

	2007	2006 (dollars in thousands)	% Change
Total operating expenses	\$ 88,935	\$ 81,150	9.6%
Add: Deferred direct mortgage loan origination expenses (1)	5,097	14,063	(63.8)%
Less: Servicing cost (2)	(11,610)	(8,042)	44.4%
Mortgage loan origination expenses	82,422	87,171	(5.4)%
Less: Net origination points and fees collected (3)	(25,678)	(32,706)	(21.5)%
Net cost to originate	\$ 56,744	\$ 54,465	4.2%
Total mortgage loan originations	\$ 1,676,618	\$ 4,079,195	(58.9)%
Net cost to originate as percentage of volume	3.38%	1.34%	

(1) Represents the amount of direct expenses incurred and deferred in the period in accordance with Financial Accounting Standard No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases* SFAS 91.

(2) Servicing cost consists of direct expenses and allocated corporate overhead of the servicing division.

(3) Total net origination points and fees represent amounts received from borrowers during the period less amounts paid to brokers, on all mortgage loans originated during the period.

Income Taxes

The provision for income taxes was \$5.2 million for the three months ended June 30, 2007 and was attributable to profits from our Canadian operations and minimum federal and state income taxes, as we could not record a tax benefit resulting from the operating loss due to limitations on net operating loss carryforwards.

As of December 31, 2006, we had net operating loss carry-forwards for tax purposes of approximately \$75 million and \$9 million for federal and state tax purposes respectively, which have been classified as a deferred tax asset. The net operating loss carry-forwards are attributable to the Aames transaction which occurred in 2006. Utilization of the net operating loss carry-forwards acquired in the Aames transaction are subject to federal and state income tax rules that limit the utilization due to the occurrence of an ownership change under IRC Section 382. The amount of deferred tax asset recorded for these net operating loss carryforwards has considered any existing limitations on their utilization under

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Section 382. Note that it is possible that additional limitations on the utilization of these losses could be incurred if additional ownership changes were to occur. If not used, these carry-forwards will expire in varying amounts during fiscal years 2017 through 2025.

As a result of losses incurred by the Company in the fourth quarter of 2006 as well as continued losses in 2007, the availability of future taxable earnings to fully utilize net operating loss carry-forwards obtained in the Aames acquisition is uncertain. Consequently, a valuation allowance of \$112.1 million was established and reflected in the year ended December 31, 2006 against the net deferred tax assets of \$232.7 million as of December 31, 2006. The deferred tax asset of \$118.5 million at June 30, 2007 represents federal and state income taxes paid in prior years.

REIT Operating Results

Net revenues for the REIT were \$18.2 million for the three months ended June 30, 2007, resulting primarily from net interest income after provision for losses on loans held for investment. The REIT incurred expenses of \$9.3 million for the same period related to servicing and management fees charged by AHL in accordance with an administration and servicing agreement between the two parties. Resulting net income for the same period was \$8.8 million.

Six Months Ended June 30, 2007 Compared to the Six Months Ended June 30, 2006

Executive Summary

We recorded a net loss of \$337.1 million for the six months ended June 30, 2007, or \$13.31 per diluted share, compared to net income of \$77.1 million, or \$3.45 per diluted share for the six months ended June 30, 2006. This net loss was the result of the following factors:

Mortgage loan origination volume dropped 53.6%, from \$7.7 billion for the six months ended June 30, 2006 to \$3.6 billion for the same period in 2007. Production was negatively impacted by adverse secondary market conditions and continued restrictions of our product menu and underwriting guidelines.

We sold \$4.8 billion in mortgage loans during the six months ended June 30, 2007 at a discount to par (including hedge losses) of 2.92% and recorded a net loss on sale of mortgage loans of \$140.4 million. This loss was the direct result of the \$2.7 billion of loans sold at a substantial discount to par in March 2007. The sale of these loans in March 2007 resulted in a pre-tax loss of \$150 million, but provided the Company with approximately \$134 million in cash after paying off the warehouse lenders. During the six months ended June 30, 2006, we sold \$6.7 billion in loans at a premium to par (including hedge gains) of 2.39%, resulting in a net gain on sale of mortgage loans of \$160.2 million.

Net interest income before provision for loan losses declined by \$60.9 million or 38.0%, from \$160.4 million for the six months ended June 30, 2006 to \$99.5 million for the same period in 2007. This decline was the result of a variety of factors: (1) a reduction in loans held for sale, (2) higher levels of non-performing loans, (3) the issuance of \$56 million in trust preferred securities and \$230 million in term debt during the first quarter of 2007 and (4) an increase in LIBOR rates.

The provision for losses on mortgage loans held for investment increased \$27.9 million or 94.2% from \$29.6 million for the six months ended June 30, 2006 to \$57.5 million for the same period in 2007. The increase in the provision was due to the \$103.5 million increase in the level of REO during the first half of 2007 compared to the \$25.8 million increase in REO in the first half of 2006 and an increase in the estimated loss severity rate on REO assets.

The provision for market valuation losses on loans held for sale increased \$48.7 million, from \$14.9 million for the six months ended June 30, 2006 to \$63.6 million for the same period in 2007. This provision increase was the result of increasing delinquencies in loans originated and repurchased that remained in loans held for sale at June 30, 2007, coupled with a sharp decline in secondary market prices for delinquent first and second lien non-prime mortgage loans.

Repurchase loan activity increased significantly in 2007 as we repurchased \$192.8 million in loans from investors and paid \$67.2 million cash settlements to resolve repurchase claims during the six months ended June 30, 2007 compared to \$53.1 million in repurchased loans and no cash settlements paid during the first six months of 2006. This resulted in an increase in the provision for losses on repurchases of \$23.4 million, from \$2.9 million for the six months ended June 30, 2006 to \$26.3 million for the same period in 2007.

Operating expenses increased \$42.6 million or 26.7%, from \$159.8 million for the six months ended June 30, 2006 to \$202.4 million for the same period in 2007, primarily due to additional personnel and occupancy expenses from the Aames operation acquired in the fourth quarter of 2006 and legal and investment banking fees associated with our merger with Lone Star.

The provision for income taxes of \$14.8 million for the six months ended June 30, 2007 was attributable to profits generated in Canada and United States federal and state minimum income taxes, as we could not record a tax benefit resulting from the operating loss due to limitations on net operating loss carryforwards.

Net cost to originate, a key measure of our efficiency in originating mortgage loans, increased significantly from 1.46% for the six months ended June 30, 2006 to 3.68% for the same period in 2007 as operating expenses increased 26.7% and production declined 53.6% in the first half of 2007 compared to 2006.

Net Revenues

Net revenues and key indicators that affect our net revenues were as follows for the six months ended June 30:

	2007	2006	Change	% Change
	(dollars in thousands)			
Interest income (1)	\$ 353,359	\$ 399,507	\$ (46,148)	(11.6)%
Interest expense (2)	(253,866)	(239,111)	(14,755)	6.2%
Net interest income	99,493	160,396	(60,903)	(38.0)%
Provision for losses on mortgage loans held for investment	(57,470)	(29,599)	(27,871)	94.2%
Net interest income after provision	42,023	130,797	(88,774)	(67.9)%
Gain (loss) on sale of mortgage loans	(180,435)	151,226	(331,661)	(219.3)%
Mortgage loan servicing income	7,727	7,439	288	3.9%
Other income	15,821	5,400	10,421	193.0%
Total net revenues	\$ (114,864)	\$ 294,862	\$ (409,726)	(139.0)%
Mortgage loan originations	\$ 3,558,579	\$ 7,666,736	\$ (4,108,157)	(53.6)%
Mortgage loan sales	\$ 4,804,384	\$ 6,715,256	\$ (1,910,872)	(28.5)%
Mortgage loans securitized	\$	\$ 2,053,827	\$ (2,053,827)	(100.0)%
Average inventory of mortgage loans	\$ 9,566,460	\$ 10,090,662	\$ (524,202)	(5.2)%
Annualized interest income as a percentage of average inventory of mortgage loans	7.39%	7.92%		
Average outstanding borrowings	\$ 9,249,424	\$ 9,718,242	\$ (468,818)	(4.8)%

(1) Interest income includes prepayment penalty income and gains and losses from certain hedging activities.

(2) Interest expense includes gains and losses from hedging activities and amortization of debt issuance costs.

Interest Spread on Mortgage Loans Held for Sale

Interest income on mortgage loans held for sale decreased \$85.9 million or 58.9%, from \$145.9 million for the six months ended June 30, 2006 to \$60.0 million for the same period in 2007. This was reflective of a 98 basis point decrease in the average interest rate on mortgage loans held for sale, from 8.15% in the first half of 2006 to 7.17% in the first half of 2007 and a \$1.9 billion decrease in the average portfolio of loans held for sale from \$3.6 billion in the first half of 2006 to \$1.7 billion in the first half of 2007. Due to increased competition in 2006, we dropped the interest rates charged on new loans to borrowers by 35 basis points from the first half of 2006 to the first half of 2007, and the yield was further reduced 62 basis points due to increases in non-performing loans, resulting in a net decrease in the average rate of 98 basis points. The average balance of non-performing mortgage loans held for sale increased from \$55.5 million during the six months ended June 30, 2006 to \$158.6 million for the same period in 2007 as the rate of delinquencies and the level of repurchased loans increased. The \$1.9 billion decrease in the average portfolio of loans held for sale in the first half of 2007 was primarily the result of the sale of substantially all (\$2.7 billion) of our loans held for sale inventory on March 16, 2007 combined with a \$2.4 billion decline in mortgage loan production in the second quarter of 2007 compared to 2006.

Interest expense on mortgage loans held for sale decreased \$44.5 million or 50.8% from \$87.6 million for the six months ended June 30, 2006 to \$43.1 million for the same period in 2007. This decrease resulted from a 39 basis point increase in our cost of funds rate, from 5.40% in the first half of 2006 to 5.79% in the first half of 2007 due to the increase in the average One Month LIBOR rate (from 4.84% to 5.32%) offset by a \$1.8 billion decrease in our average warehouse borrowings, including the ABCP facility, from \$3.3 billion for the six months ended June 30, 2006 to \$1.5 billion in the same period in 2007. The amortization of commitment fees paid to warehouse lenders increased \$2.0 million in the first half

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of 2007 due to the termination of certain warehouse agreements and the ABCP facility, and represented 70 basis points of our average warehouse borrowings in the first half of 2007 compared to 20 basis points in the first half of 2006.

For the six months ended June 30, 2007, the resulting interest spread on our portfolio of mortgage loans held for sale declined \$43.4 million or 187 basis points, from 2.55% in 2006 to 0.68% in 2007, as interest expense, including commitment fees, decreased \$42.5 million or 89 basis points and interest income decreased by \$85.9 million or 98 basis points.

Interest Spread on Mortgage Loans Held for Investment

Interest income on mortgage loans held for investment increased \$ 42.3 or 18.5%, from \$228.5 million for the six months ended June 30, 2006 to \$270.7 million for the same period in 2007. This increase was primarily the result of a \$1.4 billion or 21.3% increase in the average portfolio of loans held for investment from \$6.5 billion in the first half of 2006 to \$7.9 billion in the first half of 2007, as we continued to execute our securitization program and added securitized loans acquired from Aames. The average interest rate on loans held for investment decreased slightly, from 7.02% for the six months ended June 30, 2006 to 6.86% for the same period in 2007 as the average balance of non-performing loans increased from \$125.6 million in the first half of 2006 to \$416.3 million in the same period in 2007. Prepayment penalty fees received and other income fell \$2.5 million or 10.1% in the first six months of 2007 compared to the same period of 2006, as loan prepayments began to slow due to falling home prices and tighter credit conditions. The \$1.4 billion increase in the average portfolio of loans held for investment in the first half of 2007 was caused by the addition of \$1.1 billion in securitized loans during the twelve months ended June 30, 2007 and the \$1.1 billion in securitized loans acquired from Aames held during the first half of 2007, less normal portfolio run-off due to principal repayments.

Interest expense on mortgage loans held for investment increased \$50.6 million or 31.7% from \$159.5 million for the six months ended June 30, 2006 to \$210.1 million for the same period in 2007. This increase was primarily the result of the \$1.3 billion or 20.1% increase in our average securitized bond financing, from \$6.5 billion in the first half of 2006 to \$7.8 billion in the first half of 2007 plus a 46 basis point increase in our cost of funds rate, from 4.92% for the six months ended June 30, 2006 to 5.38% for the same period in 2007. The 46 basis point rate increase in our cost of funds was caused by the increase in the average One Month LIBOR rate. The \$1.3 billion increase in the average securitized bond financing in the first half of 2007 was the result of the addition of \$1.1 billion in securitized bonds during the twelve months ended June 30, 2007 and the \$1.1 billion in securitized bonds acquired from Aames and held during the first half of 2007, less normal bond amortization.

The resulting interest spread declined \$6.9 million from \$105.3 million for the six months ended June 30, 2006 to \$98.4 million for the same period in 2007, and the interest margin declined 77 basis points, from 3.21% in 2006 to 2.44% in 2007.

Interest expense on other term debt was \$10.6 million for the six months ended June 30, 2007 and represented interest on (1) the \$56 million in trust preferred securities at 9.01% (from issuance on January 11, 2007), (2) the \$230 million Farallon loan at 13.00% (from issuance on March 30, 2007) and (3) the revolving balances outstanding during the period on the senior credit facility secured by mortgage servicing rights and servicing advances.

The components of our net interest income were as follows for the six months ended June 30:

	2007			2006		
	Interest	Average		Interest	Average	
	Income	Balance	Average	Income	Balance	Average
	(Expense)	Outstanding	Rate	(Expense)	Outstanding	Rate
	(dollars in thousands)					
Mortgage loans held for sale (1):						
Interest income	\$ 60,027	\$ 1,673,864	7.17%	\$ 145,919	\$ 3,583,397	8.15%
Interest expense	(43,109)	1,481,265	(5.79)	(87,630)	3,252,287	(5.40)
Commitment fee expense	(5,221)		(0.70)	(3,200)		(0.20)
Spread	11,697		0.68	55,089		2.55
Mortgage loans held for investment:						
Interest income	270,737	7,892,597	6.86	228,454	6,507,265	7.02
Prepayment penalty and other income	22,595		0.57	25,134		0.76
Interest expense	(210,121)	7,768,159	(5.38)	(159,495)	6,465,955	(4.92)
Hedging gains and bond issue cost amortization, net	15,195		0.39	11,214		0.35
Spread	98,406		2.44	105,307		3.21

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Net interest margin	110,103	9,566,460	2.30	160,396	10,090,662	3.19
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	2007			2006		
	Interest	Average		Interest	Average	
	Income	Balance	Average	Income	Balance	Average
	(Expense)Outstanding	Rate	(Expense)	Outstanding	Rate	
(dollars in thousands)						
Other term debt:						
Interest expense gin	(10,610)	174,631	(12.15)			
Net interest income	\$99,493	\$ 9,566,460	2.08%	\$ 160,396	\$ 10,090,662	3.19%

(1) Includes mortgage loans held for sale and mortgage loans held for securitization.

Provisions and Reserves for Losses

We make provisions for losses on our portfolio of mortgage loans held for investment based upon our estimate of expected losses resulting from loans in various stages of delinquency, calculated using assumptions of loss frequency and loss severity.

We make market valuation provisions (LOCOM) for classes of loans within our portfolio of mortgage loans held for sale that are current, delinquent, aged or have documentation exceptions, when the current prices in the secondary market for loans with these characteristics are lower than our cost.

Certain 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 loan an early payment default. 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 from the date of sale. We estimate provisions for repurchase losses on mortgage loans sold in the secondary market based upon our estimate of the expected frequency of repurchase claims and a loss severity rate assumption.

The assumptions used in estimating losses are updated periodically based on our actual experience as well as current market trends.

The total provision for losses detailed below increased \$97.8 million or 189.4%, from \$51.7 million for the six months ended June 30, 2006 to \$149.5 million for the same period in 2007. This provision increase was driven by increasing delinquencies in our mortgage loan portfolio, declining prices for delinquent loans in the secondary market and an increase in the level of repurchase claims. Loans more than 30 days delinquent (excluding mortgage loans acquired from Aames) increased from 3.86% at June 30, 2006 to 9.47% at June 30, 2007. The primary reasons for the increase in 30+ day delinquencies were the aging of the portfolio, higher delinquencies from the late 2005 and 2006 securitizations and additional delinquencies from repurchased loans.

The combined provisions for losses on mortgage loans held for investment and REO increased \$27.9 million or 94.2% from \$29.6 million for the six months ended June 30, 2006 to \$57.5 million for the same period in 2007. The increase in the 2007 provision was due to the \$103.5 million increase in the level of REO (acquired in settlement for mortgage loans held for sale and mortgage loans held for investment) from December 31, 2006 to June 30, 2007 compared to the \$25.8 million increase in REO during the same period in 2006 and an increase in loss severity rates on REO assets.

The provision for LOCOM on loans held for sale increased \$48.7 million in the first half of 2007, from \$14.9 million for the six months ended June 30, 2006 to \$63.6 million for the same period in 2007, and represented the largest portion of the increase in the total provision for losses. This provision increase was the result of increasing delinquencies in loans originated and repurchased that remained in loans held for sale at June 30, 2007, coupled with a sharp decline in secondary market prices for delinquent first and second lien non-prime mortgage loans. The secondary market investors were especially punitive on second-lien non-prime mortgage loans and first lien non-prime mortgage loans with low credit scores, high loan-to-value ratios and stated income documentation in 2007. In response to these market factors, we continued to change our credit guidelines during the first and second quarters of 2007 and reduce our menu of loan programs to restrict the number of loans we originated with these characteristics, including first and second lien combo loans.

The provision for repurchase losses increased \$23.4 million in the first half of 2007, from \$2.9 million in the six months ended June 30, 2006 to \$26.3 million in the same period in 2007. From late 2006 continuing into the second quarter of 2007, certain investors became more aggressive regarding the identification and pursuit of repurchase claims against the Company. During the six months ended June 30, 2007, we repurchased \$192.8 million in mortgage loans and paid \$67.2

million in cash settlements to resolve repurchase claims and, in some cases, eliminate the requirement to repurchase mortgage loans in the future from certain investors both of these actions reduced the repurchase reserve during the first half of 2007. At June 30, 2007, we had \$62.6 million in qualified repurchase claims and a reserve for losses on repurchase claims of \$45.7 million.

The total reserves for losses outlined below decreased \$19.0 million, from \$326.0 million at December 31, 2006 to \$307.0 million at June 30, 2007. In addition, the key ratio of loss reserves on mortgage loans held for investment to principal balance outstanding on mortgage loans held for investment increased from 1.84% at December 31, 2006 to 2.32% at June 30, 2007.

The total provision for losses and their related reserve balances were comprised of the following:

	2007	2006	Change	% Change
	(dollars in thousands)			
Provision for losses for the six months ended June 30:				
Mortgage loans held for investment	\$ 10,431	\$ 20,032	\$ (9,601)	(47.9)%
Real estate owned	47,039	9,567	37,472	391.7%
Provision for losses on mortgage loans held for investment	57,470	29,599	27,871	94.2%
LOCOM valuation	63,613	14,916	48,697	326.5%
Repurchases	26,346	2,913	23,433	804.4%
Premium recapture	2,050	4,230	(2,180)	(51.5)%
Total provision for losses	\$ 149,479	\$ 51,658	\$ 97,821	189.4%

	June 30,	December 31,	Change	% Change
	2007	2006	(dollars in thousands)	
Reserves for losses at period end:				
Mortgage loans held for investment (1)(2)	\$ 144,160	\$ 138,250	\$ 5,910	4.3%
Real estate owned (3)	73,905	40,364	33,541	83.1%
LOCOM valuation (4)	40,060	36,525	3,535	9.7%
Repurchases (5)	45,721	106,111	(60,390)	(56.9)%
Premium recapture (5)	3,126	4,798	(1,672)	(34.8)%
Total reserves for losses	\$ 306,972	\$ 326,048	\$ (19,076)	(5.9)%

Principal balance at period end (1):				
Mortgage loans held for investment	\$ 6,200,475	\$ 7,503,245	\$ (1,302,770)	(17.4)%

Reserve balance as a percentage of mortgage loans held for investment				
(6)	2.32%	1.84%		

- (1) The reserve for losses on mortgage loans held for investment in 2007 excludes reserves for losses on Aames mortgage loans due to the effect of purchase accounting. The principal balance of mortgage loans held for investment at June 30, 2007 also excludes any Aames related balances for consistency in presentation within this table.
- (2) Reserve for losses on mortgage loans held for investment is included in mortgage loans held for investment on the consolidated balance sheets.
- (3) Reserve for losses on real estate owned is included in real estate owned on the consolidated balance sheets.
- (4) Reserve for LOCOM valuation losses are included in loans held for sale on the consolidated balance sheets.
- (5) Reserves for repurchases and premium recapture are included in accrued expenses and other liabilities on the consolidated balance sheets.
- (6) The reserve balance percentages for mortgage loans held for investment are calculated by dividing the reserve for losses on mortgage loans held for investment by the principal balance of mortgage loans held for investment

Gain (Loss) on Sale of Mortgage Loans

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We recorded a gross loss on sale of mortgage loans of \$132.5 million (\$140.4 million after derivative losses) on loan sales of \$4.8 billion for the six months ended June 30, 2007 compared to a gross gain on sale of mortgage loans of \$143.9 million (\$160.2 million after derivative gains) on loan sales of \$6.7 billion for the same period in 2006. These results

translate into loans sold at a 2.92% discount to par (97.08% sell price) for the \$4.8 billion in loans sold during the six months ended June 30, 2007 compared to loans sold at a 2.39% premium to par (102.39% sell price) during the same period in 2006. This change in the profitability of our loan sales activities were the result of the following factors:

Mortgage loan production volume dropped \$4.1 billion during the first half of 2007 compared to 2006 due to adverse secondary market conditions and continued restrictions of our product menu and underwriting guidelines. This lower production volume contributed to the \$1.9 billion decline in loan sales volume in the first half of 2007.

The steady increase in delinquency and default rates on non-prime loans in the overall market in 2007 caused expected loss rates to rise, putting pressure on secondary market prices.

The decline in the rate of home price appreciation and declining home prices reduced the premiums investors were willing to pay for non-prime mortgage loans.

In March 2007, we sold \$2.7 billion of loans held for sale at a substantial discount to par in order to alleviate the cash demands from warehouse lender margin calls. The sale of these loans resulted in a pre-tax loss of \$150 million, but provided the Company with approximately \$134 million in cash after paying off the warehouse lenders.

The net loss on mortgage loan sales (after derivative losses) of \$140.4 million for the six months ended June 30, 2007 was further increased by the provision for market valuation of \$63.6 million and the provision for repurchases and premium recapture of \$28.4 million. Each of these provisions was higher in 2007 than during the comparable period in 2006 as outlined in the previous section Provisions and Reserves for Losses. Net origination points and fees for the six months ended June 30, 2007 were \$66.4 million, an increase of \$27.1 million compared to the \$39.3 million for the comparable period in 2006. This increase in net origination points and fees, which partially offset the increased provision expenses, was due to reduced yield spread premium fees paid to brokers and increased fees collected from borrowers, due in large part, to the increase in retail loan originations.

The components of the gain (loss) on sale of mortgage loans were as follows for the six months ended June 30:

	2007	2006 (1)	Change	% Change
		(dollars in thousands)		
Gross gain (loss) on mortgage loan sales	\$ (132,528)	\$ 143,851	\$ (276,379)	(192.1)%
Net gain (loss) on derivatives	(7,826)	16,322	(24,148)	(147.9)%
Net gain (loss) on sale of mortgage loans	(140,354)	160,173	(300,527)	(187.6)%
Provision for market valuation LOCOM	(63,613)	(14,916)	(48,697)	326.5%
Provision for loss on repurchases and premium recapture	(28,396)	(7,142)	(21,254)	297.6%
Net origination points and fees recognized on sale	66,435	39,293	27,142	69.1%
Direct mortgage loan origination expenses	(14,507)	(26,182)	11,675	(44.6)%
Total net gain (loss) on sale of mortgage loans (2)	\$ (180,435)	\$ 151,226	\$ (331,661)	(219.3)%
Whole loan sales (2)	\$ 4,804,384	\$ 6,715,256	\$ (1,910,872)	(28.5)%
Gain (loss) on sale rates (3):				
Gross gain (loss) on mortgage loan sales	(2.76)%	2.15%		
Net gain (loss) on derivatives	(0.16)%	0.24%		
Net gain (loss) on sale of mortgage loans	(2.92)%	2.39%		

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- (1) Reclassified to conform to 2007 presentation.
 - (2) In accordance with purchase accounting requirements, mortgage loans acquired from Aames were recorded at fair market value, therefore no significant gains or losses were recognized on the sale of mortgage loans acquired from Aames.
 - (3) Gain on sale rates are calculated based on the respective amounts divided by whole loan sales, excluding Aames whole loan sales.

Operating Expenses

Operating expenses were as follows for the six months ended June 30:

	2007	2006 (dollars in thousands)	Change	% Change
Salaries, wages and benefits	\$ 114,064	\$ 96,800	\$ 17,264	17.8%
General and administrative	40,996	30,694	10,302	33.6%
Occupancy	25,247	12,737	12,510	98.2%
Advertising and promotion	12,210	10,459	1,751	16.7%
Depreciation and amortization	9,915	9,120	795	8.7%
Total operating expenses	\$ 202,432	\$ 159,810	\$ 42,622	26.7%
Total serviced loans at period end	\$ 8,471,942	\$ 9,526,735	\$ (1,054,793)	(11.1)%
Total number of employees at period end	2,591	2,902	(311)	(10.7)%

Salaries, Wages and Benefits. Salaries, wages and benefits increased \$17.3 million or 17.8% during the six months ended June 30, 2007, primarily due to the effects of employees added from the merger with Aames in the fourth quarter of 2006. Average headcount was 3,233 during the six months ended June 30, 2007 compared to 2,730 during the same period in 2006. Headcount declined steadily during the six months ended June 30, 2007 from 4,196 at January 1, 2007 to 2,591 at June 30, 2006 as a result of the following actions taken: (1) the elimination of transition staff related to the Aames acquisition, (2) our election not to replace staff attrition losses as they occurred and (3) our decision to close poor performing branch offices.

General and Administrative. General and administrative expenses increased \$10.3 million or 33.6% during the six months ended June 30, 2007 compared to the same period in 2006 due primarily to increases in legal and investment banking fees, including those associated with the merger with Lone Star and the defense against stockholder lawsuits.

Occupancy. Occupancy expenses increased \$12.5 million or 98.2% during the six months ended June 30, 2007 primarily due to increased leasing costs associated with the additional Aames locations acquired in the merger. In addition, we recorded a \$4.0 million expense in the first six months of 2007 to record the acceleration of the lease obligations associated with the closure of several poor performing branches.

Advertising and Promotion. Advertising and promotion expenses increased \$1.8 million or 16.7% during the six months ended June 30, 2007 driven by increased spending on referrals and leads to support our retail mortgage loan origination platform.

Depreciation and Amortization. Depreciation and amortization increased 8.7% during the six months ended June 30, 2007 due primarily to additional investments in technology.

Net Cost to Originate

We monitor our net cost to originate mortgage loans, as we believe that it provides a measurement of efficiency in our mortgage loan origination process. The calculation of this net cost to originate was as follows for the six months ended June 30:

	2007	2006 (dollars in thousands)	% Change
Total operating expenses	\$ 202,432	\$ 159,810	26.7%
Add: Deferred direct mortgage loan origination expenses (1)	8,775	26,860	(67.3)%
Less: Servicing cost (2)	(26,379)	(14,989)	76.0%
Mortgage loan origination expenses	184,828	171,681	7.7%
Less: Net origination points and fees collected (3)	(53,760)	(59,813)	(10.1)%
Net cost to originate	\$ 131,068	\$ 111,868	17.2%

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Total mortgage loan originations	\$ 3,558,579	\$ 7,666,736	(53.6)%
Net cost to originate as percentage of volume	3.68%	1.46%	

-
- (1) Represents the amount of direct expenses incurred and deferred in the period in accordance with Financial Accounting Standard No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases* (SFAS 91).

- (2) Servicing cost consists of direct expenses and allocated corporate overhead of the servicing division.
- (3) Total net origination points and fees represent amounts received from borrowers during the period less amounts paid to brokers, on all mortgage loans originated during the period.

Income Taxes

The provision for income taxes was \$14.8 million for the six months ended June 30, 2007 and was attributable to profits from our Canadian operations and minimum federal and state income taxes, as we could not record a tax benefit resulting from the operating loss due to limitations on net operating loss carryforwards.

As of December 31, 2006, we had net operating loss carry-forwards for tax purposes of approximately \$75 million and \$9 million for federal and state tax purposes respectively, which have been classified as a deferred tax asset. The net operating loss carry-forwards are attributable to the Aames transaction which occurred in 2006. Utilization of the net operating loss carry-forwards acquired in the Aames transaction are subject to federal and state income tax rules that limit the utilization due to the occurrence of an ownership change under IRC Section 382. The amount of deferred tax asset recorded for these net operating loss carryforwards has considered any existing limitations on their utilization under Section 382. Note that it is possible that additional limitations on the utilization of these losses could be incurred if additional ownership changes were to occur. If not used, these carry-forwards will expire in varying amounts during fiscal years 2017 through 2025.

As a result of losses incurred by the Company in the fourth quarter of 2006 as well as continued losses in 2007, the availability of future taxable earnings to fully utilize net operating loss carry-forwards obtained in the Aames acquisition is uncertain. Consequently, a valuation allowance of \$112.1 million was established and reflected in the year ended December 31, 2006 against the net deferred tax assets of \$232.7 million as of December 31, 2006. The deferred tax asset of \$118.5 million at June 30, 2007 represents federal and state income taxes paid in prior years.

REIT Operating Results

Net revenues for the REIT were \$54.2 million for the six months ended June 30, 2007, resulting primarily from net interest income after provision for losses from securitizations. The REIT incurred expenses of \$19.4 million for the same period related to servicing and management fees charged by AHL in accordance with an administration and servicing agreement between the two parties. Resulting net income for the same period was \$34.8 million.

Liquidity and Capital Resources

As a mortgage banking company, our cash requirements include the funding of mortgage loan originations, repurchases of previously sold mortgage loans, interest expense on and repayment of principal on credit facilities and securitization bond financing, including posting additional cash collateral as required under margin provisions of various warehouse credit requirements, operational expenses, servicing advances, hedging margin requirements, and tax payments. Our cash requirements also included the funding of quarterly dividends on preferred shares issued by our REIT subsidiary. We fund these cash requirements with cash received from mortgage loan sales, borrowings under warehouse credit facilities and asset backed commercial paper and securitization and other financing secured by mortgage loans and related assets, cash distributions from our mortgage-related securities, interest collections on mortgage loans held for sale and mortgage loans held for investment, servicing assets, servicing fees and other servicing income, and points and fees collected from the origination of mortgage loans.

Warehouse Facilities

We use our various warehouse credit facilities to finance the funding of our loan originations. We sell or securitize our mortgage loans generally within one to four months from origination and use the proceeds primarily to pay down the warehouse credit facilities. Each of our current warehouse credit facilities also contains a sub-limit for wet funding, which is the funding of loans for which the collateral custodian has not yet received the related loan documents.

Except as otherwise noted below, all of our warehouse credit facilities accrued interest at a rate based upon one-month LIBOR plus a specified spread and as of June 30, 2007 had other material terms and features as follows:

	Outstanding	Facility
	Amount	Amount
	(in thousands)	
Wachovia Bank, N.A. expiring March 2008	\$ 512,556	\$ 750,000
Credit Suisse First Boston Mortgage Capital LLC expiring March 2008 (1)	324,082	600,000
Morgan Stanley Mortgage Capital Holdings LLC expired July 2007	9,385	650,000
Natixis Real Estate Capital Inc. expired August 2007		600,000
Merrill Lynch Capital Canada, Inc. expired July 2007 (2)	32,290	75,500
Deutsche Bank AG, Canada Branch expiring June 2008 (2)		141,600
Total credit facilities	\$ 878,313	\$ 2,817,100

- (1) Interest at overnight LIBOR plus a specified spread.
(2) Interest at one-month Bankers' Acceptance rate plus a spread.

One or more of our credit facilities include sublimits for aged and delinquent loans, as well as for real estate owned (properties acquired through foreclosure of defaulted mortgage loans or through deeds in lieu of foreclosure) and subordinated asset-backed bonds.

Our warehouse and other credit facilities contain customary covenants including maximum leverage, minimum liquidity, profitability and net worth requirements, and limitations on other indebtedness. If we fail to comply with any of these covenants or otherwise default under a facility, the lender has the right to terminate the facility and require immediate repayment that may require sale of the collateral at less than optimal terms. In addition, if we default under one facility, it would generally trigger a default under our other facilities. As of June 30, 2007, we were in compliance with all covenant requirements for each of the facilities.

In 2007, the Company sold substantial amounts of its loans held for sale and obtained the \$230 million Farallon Loan providing cash and liquidity which was used to repay many of the Company's then-existing warehouse facilities, after which such facilities were terminated. Specifically, through August 31, 2007, the Company repaid and terminated the warehouse facilities with Lehman Brothers Bank, FSB, Residential Funding Company, LLC, Goldman Sachs Mortgage Company and Merrill Lynch Bank USA,. Additionally, as of August 31, 2007, the Company had repaid all amounts outstanding under, and allowed to expire, the facilities provided by Morgan Stanley Mortgage Capital Holdings LLC, by Natixis Real Estate Capital Inc. (formerly known as IXIS Real Estate Capital Inc.) and by Merrill Lynch Capital Canada 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, on March 29, 2007, 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 28, 2008, and the maximum committed amount available for borrowing remained at \$600 million. Under the agreement with Wachovia, as amended on May 1, 2007 and on July 5, 2007, the term of the Wachovia repurchase facility was extended through March 25, 2008, and the maximum committed amount available for borrowing was increased to \$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, both effective on and after July 31, 2007. Pursuant to these amendments, the parties modified the definition of Adjusted Tangible Net Worth to include the amount of the Company's pool trust preferred securities, and in addition, the CSFB amendment contains an additional sublimit for performing aged warehouse loans.

As of September 30, 2007, the company had warehouse facilities outstanding as follows:

Warehouse Lender	Outstanding	Total Facility	Expiration Date
	Amount	Amount	
	(in millions)		
Credit Suisse First Boston Mortgage Capital LLC (1)	\$ 240	\$ 600	03/28/2008
Wachovia Bank, LLC (2)	325	1,000	03/25/2008
Deutsche Bank AG, Canada Branch (3)	136	141	06/28/2008
Total	\$ 701	\$ 1,741	

- (1) Interest at overnight LIBOR plus a specified spread.
- (2) Interest at One Month LIBOR plus a specified spread.

(3) Interest at one-month Bankers' Acceptance rate plus a spread.

At September 30, 2007, Accredited had total liquidity of approximately \$140 million which consisted of cash and cash equivalents plus available collateralized borrowing capacity on our warehouse and other lines of credit.

Asset Backed Commercial Paper Facility

As part of its financing strategy, Accredited at December 31, 2006 maintained a \$2.5 billion asset-backed commercial paper (ABCP) facility. Based upon adverse market conditions for asset-backed commercial paper collateralized by non-prime mortgage loans, the Company paid off the SLNs and subordinated notes and terminated the ABCP facility effective in May 2007.

REIT Activity

At June 30, 2007 the REIT had cash of \$64.8 million, an increase of \$41.5 million from December 31, 2006. During the six months ended June 30, 2007, net cash provided by operating activities totaled \$50.8 million net cash provided by investing activities totaled \$1.3 billion and net cash used in financing activities totaled \$1.3 billion.

In January 2007, we completed a securitization containing \$0.8 billion of first and second priority residential mortgage loans through the REIT. The securitization utilized a senior/subordinated structure consisting of senior and subordinated notes with a final stated maturity date in approximately thirty years. The securitization is structured as a financing; therefore, both the mortgage loans and the debt represented by the notes will remain on our consolidated balance sheet. We used the proceeds from this securitization primarily to repay warehouse financing for the mortgage loans.

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

Accredited has irrevocably and unconditionally agreed to pay in full to the holders of each share of the REIT's Series A Preferred Shares, as and when due, regardless of any defense, right of set-off or counterclaim which the REIT or Accredited may have or assert: (i) all accrued and unpaid dividends (whether or not declared) payable on the REIT's Series A Preferred Shares, (ii) the redemption price (including all accrued and unpaid dividends) payable with respect to any of the REIT's Series A Preferred Shares redeemed by the REIT and (iii) the liquidation preference, if any, payable with respect to any of the REIT's Series A Preferred Shares. Accredited's guarantee is subordinated in right of payment to Accredited's indebtedness, on parity with the most senior class of Accredited's preferred stock and senior to Accredited's common stock. At June 30, 2007, the aggregate redemption value of the total preferred shares outstanding was \$102.3 million. Based on total preferred shares outstanding at June 30, 2007, the REIT's current annual dividend obligation totals \$10.0 million.

Market Risk

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

The objective of interest rate risk management is to control the effects that interest rate fluctuations have on the value of our assets and liabilities. Our management of interest rate risk is intended to mitigate the volatility of earnings associated with fluctuations in the unrealized gain (loss) on mortgage-related securities, the market value of loans held for sale and the net interest on loans held for investment due to changes in the current market rate of interest.

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

Derivative Instruments and Hedging Activities

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As part of our interest rate management process, we use derivative financial instruments such as Eurodollar futures and options on Eurodollar futures. In connection with our securitizations structured as financings, we entered into interest rate cap

and interest rate swap agreements. It is not our policy to use derivatives to speculate on interest rates. In accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133), as amended and interpreted, derivative financial instruments are reported on the consolidated balance sheets at their fair value.

Fair Value Hedges

We designate certain derivative financial instruments as hedge instruments under SFAS 133, and, at trade date, these instruments and their hedging relationship are identified, designated and documented. For derivative financial instruments designated as hedge instruments, we evaluate the effectiveness of these hedges against the mortgage loans being hedged to ensure that there remains adequate correlation in the hedge relationship. To hedge the adverse effect of interest rate changes on the fair market value of mortgage loans held for sale or securitization, we use derivatives as fair value hedges under SFAS 133. Once the hedge relationship is established, the realized and unrealized changes in fair value of both the hedge instruments and mortgage loans are recognized in the consolidated statement of operations in the period in which the changes occur. Any change in the fair value of mortgage loans held for sale recognized as a result of hedge accounting is reversed at the time the mortgage loans are sold. The net amount recorded in the consolidated statement of operations is referred to as hedge ineffectiveness.

Cash Flow Hedges

During the third quarter of 2004, we implemented the use of cash flow hedging on our securitization debt under SFAS 133. Pursuant to SFAS 133, hedge instruments have been designated as hedging the exposure to variability of cash flows from our securitization debt attributable to interest rate risk. During the third quarter 2005, Accredited implemented the use of cash flow hedging on its variable rate debt in Canada under SFAS 133. Pursuant to SFAS 133, hedge instruments have been designated as hedging the exposure to variability of cash flows from our variable rate debt in Canada attributable to interest rates. Cash flow hedge accounting requires that the effective portion of the gain or loss in the fair value of a derivative instrument designated as a hedge be reported as a component of other comprehensive income in stockholders' equity, and recorded into earnings in the period during which the hedged transaction affects earnings pursuant to SFAS 133. The ineffective portion on the derivative instrument is reported in current earnings as a component of interest expense.

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

Interest Rate Simulation Sensitivity Analysis

Changes in market interest rates affect our estimations of the fair value of our mortgage loans held for sale, loans held for investment and the related derivatives. Changes in fair value that are stated below are derived based upon immediate and equal changes to market interest rates of various maturities. All derivative financial instruments and interest rate sensitive financial assets and liabilities have been included within the sensitivity analysis presented. We model the change in value of our derivative financial instruments using outside valuation models generally recognized within the industry. Projected changes in the value of our loans as stated below are determined based on the change in net present value arising from the selected hypothetical changes in market interest rates. We are exposed to interest rate risk from the time the loans are funded to the time the loans are settled because the interest paid on the various warehouse facilities is based on the spot One-Month LIBOR rate. The interest rate risk associated with the interest expense paid on the various warehouse facilities has been included based on the average holding period from the time of funding to settlement. Changes in the fair value of our derivative positions with optionality have been included based on an immediate and equal change in market interest rates.

The base or current interest rate curve is adjusted by the levels shown below as of June 30, 2007:

	+100 bp	+50 bp	-50 bp	-100 bp
	(in thousands)			
Change in fair value of:				
Mortgage loans committed and held for sale	\$ (28,344)	\$ (14,318)	\$ 14,621	\$ 29,556
Derivatives related to mortgage loans committed and held for sale	19,508	9,754	(9,754)	(19,508)
Warehouse debt	(1,464)	(732)	732	1,464
Securitized debt	(91,129)	(45,916)	46,610	93,968
Derivatives related to securitized debt	60,895	30,447	(30,868)	(61,736)
Total	\$ (40,534)	\$ (20,765)	\$ 21,341	\$ 43,744

The simulation analysis reflects our efforts to balance the repricing characteristics of our interest-bearing assets and liabilities. Because the impact of +50 vs. +100 basis points and -50 vs. -100 basis points is nearly linear in nature, the interest rate simulation sensitivity analysis may be extrapolated to form conclusions about larger interest rate movements.

Contractual Obligations

The following table summarizes our contractual obligations, excluding future interest, at June 30, 2007, and the effect such obligations are expected to have on our liquidity and cash flows in future periods:

	Payments Due by Calendar Period				
	Total	Less than 1 year	1-3 Years (in thousands)	3-5 Years	More than 5 Years
Credit facilities	\$ 878,313	\$ 878,313	\$	\$	\$
Securitization bond financing(1)	7,106,379	1,406,128	3,276,062	1,281,759	1,142,430
Other borrowings	327,025	41,025			286,000
Operating lease obligations	142,736	17,866	55,412	36,155	33,303
Total	\$ 8,454,453	\$ 2,343,332	\$ 3,331,474	\$ 1,317,914	\$ 1,461,733

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

Off-Balance Sheet Financing Arrangements

In the normal course of business, in order to meet the financing needs of our borrowers, we are a party to various financial instruments with off-balance sheet risk. These financial instruments primarily represent commitments to individual borrowers to fund their loans. These instruments involve, to varying degrees, elements of interest rate risk and credit risk in excess of the amount recognized in the consolidated balance sheets. We seek to mitigate the credit risk by evaluating the creditworthiness of potential mortgage loan borrowers on a case-by-case basis. We do not guarantee interest rates to potential borrowers when an application is received. We quote interest rates to borrowers which are generally subject to change by us. Although we make every effort to honor such quotes, the quotes do not constitute interest rate lock commitments. Interest rates conditionally approved following the initial underwriting of applications are subject to adjustment if any conditions are not satisfied. We commit to originating loans, in many cases dependent upon the borrower's satisfying various conditions. These commitments to fund individual borrower loans totaled \$528 million as of June 30, 2007.

Accredited has irrevocably and unconditionally agreed to pay in full to the holders of each share of the REIT's Series A Preferred Shares, as and when due, regardless of any defense, right of set-off or counterclaim which the REIT or Accredited may have or assert: (i) all accrued and unpaid dividends (whether or not declared) payable on the REIT's Series A Preferred Shares, (ii) the redemption price (including all accrued and unpaid dividends) payable with respect to any of the REIT's Series A Preferred Shares redeemed by the REIT and (iii) the liquidation preference, if any, payable with respect to any of the REIT's Series A Preferred Shares. Accredited's guarantee is subordinated in right of payment to Accredited's indebtedness, on parity with the most senior class of Accredited's preferred stock and senior to Accredited's common stock. At June 30, 2007, the aggregate redemption value of the total preferred shares outstanding was \$102.3 million. Based on total preferred shares outstanding at June 30, 2007, the REIT's current annual dividend obligation totals \$10.0 million.

Inflation

Inflation affects us most significantly in the area of mortgage loan originations by affecting interest rates. Interest rates normally increase during periods of high inflation (or in periods when the Federal Reserve Bank attempts to prevent inflation) and decrease during periods of low inflation. Inflation did not have a material impact on our operations during 2006, 2005 or 2004.

Critical Accounting Policies

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

period. Although we base our estimates and assumptions on historical 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:

mortgage loan sales

lower of cost or market (LOCOM) valuation allowance on mortgage loans held for sale

repurchase reserves on loans sold

provision for losses

interest rate risk, derivatives and hedging strategies

income taxes deferred taxes

Accounting for Mortgage Loan Sales

We generally sell mortgage loans for cash or place our mortgage loans in transactions that are accounted for in our financial statements as securitizations structured as a financing or mortgage loan sales.

During the six months ended June 30, 2007 and the years ended December 31, 2006 and 2005, we completed one, two and four securitizations, respectively. These securitizations were structured as financings. The transactions were legally structured as sales of mortgage loans, but for accounting purposes were treated as financings under SFAS 140. When we enter into a securitization structured as a financing, the mortgage loans remain on our balance sheet, retained interests are not created, and debt securities issued in the securitization replace the warehouse debt originally associated with the securitized mortgage loans. We record interest income on the mortgage loans and interest expense on the debt securities, as well as ancillary fees, over the life of the securitization, instead of recognizing a gain or loss upon closing of the transaction.

When we sell our mortgage loans in whole loan sales, the transaction is structured as a sale of mortgage loans for legal and accounting purposes and we dispose of our entire interest in the mortgage loans. Gain on sale revenue is recorded at the time we sell mortgage loans, but not when we securitize mortgage loans in transactions structured as financings. Accordingly, our financial results are significantly impacted by the timing of our mortgage loan sales and the securitization structure we may elect to implement. If we hold a significant pool of mortgage loans at the end of a reporting period, those mortgage loans will remain on our balance sheet, along with the related debt used to fund the mortgage loans. The revenue (or expense) that we generate from those mortgage loans will not be recorded until the subsequent reporting period when we sell the mortgage loans. If we elect to complete a securitization structured as a financing rather than a transaction that would generate gain on sale revenue, our gain on sale revenue will be lower and our interest income will be higher than it would have been otherwise. A number of factors influence the timing of our mortgage loan sales, our targeted disposition strategy and the whole loan sale premiums we receive, including the current market demand for our mortgage loans, the quality of the mortgage loans we originate, the sufficiency of our mortgage loan documentation, liquidity needs, and our strategic objectives. From time to time, management has delayed the sale of mortgage loans to a later period, and may do so again in the future.

Mortgage Loans Held for Sale LOCOM

Mortgage loans held for sale are carried at the lower of amortized cost or fair value. We estimate fair value by evaluating a variety of market indicators including recent trades, outstanding commitments or current investor yield requirements. More specifically we stratify the mortgage loans held for sale portfolio into first and second lien position then further break those categories into 30 day aging buckets beginning with a 0 to 29 day bucket and ending with a 60+ day past due bucket. After these buckets are established we apply fair value estimates to these buckets to arrive at a valuation allowance which is applied against our carrying amount resulting in a net fair value estimate for mortgage loans held for sale. The fair value estimate for each of the aging buckets by lien position is derived from recent trade history and pending commitments tempered by professional judgment which takes into consideration current and projected demand, an evaluation of our specific market's direction and other current macro and micro economic conditions.

Repurchase reserves on loans sold

We also accrue for liabilities associated with mortgage loans sold, which we may be requested to repurchase due to breaches of representations and warranties and early payment defaults. This repurchase liability which is reported in other liabilities is derived from an estimate of the frequency for repurchases on loans sold multiplied by the estimated severity of loss when loans are repurchased reduced by actual repurchase costs incurred for the loans sold. As these estimates are influenced by factors outside of our control, including future market conditions, and as uncertainty is inherent in these estimates, it is reasonably possible that these estimates could change and our estimated liability could prove to be too high or too low.

Provisions for Losses

We provide market valuation adjustments on certain nonperforming mortgage loans. These adjustments are based upon our estimate of expected losses, calculated using loss frequency and loss severity rate assumptions, and are based upon the value that we could reasonably expect to obtain from a sale, other than in a forced or liquidation sale. Specifically, we take into account two methods. The purpose of the dual methodology is to incorporate a hybrid approach so that we are taking into account a long-term view of losses which is flexible enough to readily adapt the loss reserve model to changes in the short and medium term. The following methods are applied at the securitization pool level. At June 30, 2007 we had 16 securitized pools and one held for securitization pool to which this methodology was applied.

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

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

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

Interest Rate Risk, Derivatives and Hedging

We regularly originate, securitize and sell fixed and variable rate mortgage loans. We face six primary periods of interest rate risk: during the period from approval of a mortgage loan application through mortgage loan funding; on our mortgage loans held for sale from the time of funding to the date of sale; and on the mortgage loans underlying our mortgage-related securities and on our mortgage loans held for investment subject to portfolio-based accounting.

Interest rate risk exists during the period from approval of a mortgage loan application through mortgage loan funding and from the time of funding to the date of sale because the premium earned on the sale of these mortgage loans is partially contingent upon the then-current market rate of interest for mortgage loans as compared to the contractual interest rate of the mortgage loans. Our use of derivatives is intended to mitigate the volatility of earnings associated with fluctuations in the gain on sale of mortgage loans due to changes in the current market rate of interest.

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

As part of our interest rate management process, we use derivative financial instruments such as interest rate swaps and caps, Eurodollar futures and options on Eurodollar futures. In connection with the securitizations structured as financings, we have entered into interest rate cap agreements and interest rate swap agreements. We do not use derivatives to speculate on interest rates. Derivative financial instruments are reported on the consolidated balance sheets at their fair value.

Fair Value Hedges

We designate certain derivative financial instruments as hedge instruments under SFAS 133, and at trade date, these instruments and their hedging relationship are identified, designated and documented. For derivative financial instruments designated as hedge instruments, we evaluate the effectiveness of these hedges against the mortgage loans being hedged to ensure there remains a highly effective correlation in the hedge relationship. To hedge the effect of interest rate changes on the fair value of mortgage loans held for sale, we are using derivatives as fair value hedges under SFAS 133. Once the hedge relationship is established, the realized and unrealized changes in fair value of both the hedge instrument and mortgage loans attributable to changes in interest rates are recognized in the period in which the changes occur. Any change in the fair value of mortgage loans held for sale attributable to changes in interest rates recognized as a result of hedge accounting is reversed at the time we sell the mortgage loans. This results in a correspondingly higher or lower gain on sale revenue at such time. The net amount recorded in the consolidated statements of operations is referred to as hedge ineffectiveness.

Cash Flow Hedges

During the third quarter 2004, we implemented the use of cash flow hedge accounting on our securitization debt under SFAS 133. Pursuant to SFAS 133, hedge instruments have been designated as hedging the exposure to variability of cash flows from our securitization debt attributable to interest rate risk. During the third quarter 2005, Accredited implemented the use of cash flow hedging on its variable rate debt in Canada under SFAS 133. Pursuant to SFAS 133, hedge instruments have been designated as hedging the exposure to variability of cash flows from our variable rate debt in Canada attributable to interest rates. Cash flow hedge accounting requires that the effective portion of the gain or loss in the fair value of a derivative instrument designated as a hedge be reported as a component of other comprehensive income in stockholders' equity, and recorded into earnings in the period during which the hedged transaction affects earnings. 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.

Recently Issued Accounting Pronouncements

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 six-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 the financial impact, if any, upon adoption on January 1, 2008, 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. The Company has not determined that it will adopt SFAS 159 concurrent with the adoption of SFAS 157 on January 1, 2008, and has not yet determined the financial impact, if any, upon adoption.

Risk Factors

You should carefully consider the following risks, together with other matters described in this Form 10-Q in evaluating our business and prospects. If any of the events referred to below actually occur, our business, financial condition, liquidity and results of operations could suffer. In that case, the trading price of our common stock could decline. The risks described below are not the only ones we face. Additional risks not presently known to us or that we currently deem immaterial may also impair our business operations. Certain statements in this Form 10-Q (including certain of the following risk factors) constitute forward-looking statements. Please refer to the section entitled "Forward-Looking Statements" on page 3 of this Form 10-Q.

Risks Related to Our Business

We face significant challenges due to adverse conditions in the non-prime mortgage industry, and we cannot assure you that we will continue to operate as a going concern.

In the third quarter of 2006, the non-prime mortgage market in which the Company operates was characterized by increased competition for loans and customers which simultaneously lowered profit margins on loans and caused lenders to be more aggressive in making loans to relatively less qualified customers. By the end of 2006, the non-prime mortgage industry was clearly being negatively impacted. The sustained pricing competition and higher risk portfolios of loans reduced the appetite for loans among whole loan buyers, who offered increasingly lower prices for loans, thereby shrinking profit margins for non-prime lenders. In addition, the higher levels of credit risk taken on by non-prime lenders resulted in higher rates of delinquency in the loans held for investment and in increasing frequency of early payment defaults and repurchase demands on loans that had been sold. These trends accelerated during the first quarter of 2007, and the industry experienced a period of turmoil which has continued into the second and third quarters of 2007. As of August 31, 2007, more than 100 mortgage companies operating in the non-prime mortgage industry have failed and many others face serious operating and financial challenges. The most notable of these failures is New Century Mortgage Corporation (New Century), one of the largest non-prime originators in recent years, which announced in early April 2007 that it would file for bankruptcy protection.

While real estate markets were booming during 2004 and 2005, and some areas experienced significant home price appreciation, many originators extended credit and underwriting standards to meet market demands. When home price appreciation leveled off, or in some areas declined, many of the loans originated in 2006 did not perform up to expectations. This decline in performance led to increases in the cost of securitizing non-prime loans as the rating agencies which rate non-prime securitizations increased loss coverage levels, requiring higher credit support for non-prime securitizations.

During 2007, a number of significant industry events occurred, including the following:

New Century announced that it would restate results for the nine months ended September 30, 2006 to account for losses on defaulted loans that it was obligated to repurchase (February 7th);

HSBC Holdings PLC, one of the world's largest banks and non-prime lenders, announced an increase in its bad debt charge for 2006, which it attributed to problems in its U.S. non-prime mortgage lending division (February 8th);

Credit-Based Asset Servicing and Securitization LLC (C-BASS) and Fieldstone Investment Corporation (Fieldstone) announced that they had entered into a definitive merger agreement under which C-BASS would acquire all of Fieldstone's outstanding common stock (February 16th);

ACC Capital Holdings, the parent company of Ameriquest Mortgage Company and Argent Mortgage Company, two large non-prime mortgage originators, announced that it had secured additional capital from Citi's Markets and Banking Division and its majority shareholder, and that Citi had agreed to become the company's primary warehouse lender and had acquired an option to buy the company's wholesale mortgage business (February 28th);

Fremont General Corp. (Fremont), another significant non-prime mortgage originator, announced that it would exit its non-prime real estate lending operations and that it was in discussions with various parties regarding the sale of this business (March 2nd);

The New York Stock Exchange suspended trading of New Century's common stock based on uncertainties concerning its liquidity position (March 12th);

Fieldstone announced that it had amended its previously announced merger agreement with C-BASS to reduce the price of Fieldstone's common stock to \$4.00 per share (March 16th);

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People's Choice Home Loan, Inc., another significant non-prime mortgage originator, filed for bankruptcy protection (March 20th);

Fremont sold approximately \$4.0 billion of non-prime residential real estate loans and entered into exclusive negotiations with the same institution to sell most of its residential real estate business (March 21st);

New Century filed for bankruptcy protection (April 2nd);

NovaStar Financial, another significant non-prime mortgage originator, initiated a formal process to explore strategic alternatives and received \$100 million in financing (April 11th);

First Horizon National Corp. blamed difficulty selling mortgages in the secondary market and increased repurchase requests for its decision to shutter its subprime business (April 20th);

H&R Block Inc. announced the sale of Option One Mortgage Corp. (Option One), another large non-prime mortgage originator, to an affiliate of Cerberus Capital Management with a transaction value equal to Option One's tangible net assets as of the date of closing less \$300 million (April 20th);

WMC, a unit of General Electric Co., announced that it would cut 771 jobs (April 20th);

Standard & Poor's Ratings Service placed its credit ratings on 612 classes of residential mortgage-backed securities backed by U.S. non-prime collateral on credit watch with negative implications because of poor collateral performance, expectation of increasing losses on the underlying collateral pools, the consequent reduction of credit support, and changes that will be implemented with respect to the methodology for rating new transactions (July 10th);

Moody's Investors Service downgraded 399 residential mortgage-backed securities and placed an additional 32 residential mortgage-backed securities under review for possible downgrade based on higher than anticipated rates of delinquency in the underlying collateral compared to current credit enhancement levels (July 10th);

General Electric Co. announced plans to sell WMC Mortgage Corp, its three-year-old U.S. non-prime mortgage unit (July 12th);

NovaStar Financial, Inc. announced an investment of \$48.8 million by MassMutual and Jefferies Capital Partners as part of a commitment to raise \$150 million in new equity to complete its formal process of exploring strategic alternatives (July 16th);

Bear Stearns announced the collapse of two of its hedge funds that had invested in non-prime mortgage securities (July 18th);

Countrywide Financial Corp.'s second-quarter net income fell 33% because of softening home prices. Countrywide cut its 2007 earnings estimate because it expects a challenging second half, including difficulty in the housing and mortgage markets (July 24th);

American Home Mortgage Investment Corp. announced a delayed payment of its quarterly cash dividend on the company's common stock and anticipated delaying payment of its quarterly cash dividends on its preferred stock in order to preserve liquidity until it obtains a better understanding of the impact that current market conditions in the mortgage industry and the broader credit market will have on the company's balance sheet and overall liquidity. American Home Mortgage said that the unprecedented disruption in the credit markets in the past few weeks caused major write-downs of its loan and security portfolios and consequently has caused significant margin calls with respect to its credit facilities (July 28th);

MGIC Investment Corporation announced that it had concluded that the value of its investment in C-BASS had been materially impaired because the market for non-prime mortgages had experienced significant turmoil beginning in February 2007, with market dislocations accelerating to unprecedented levels beginning in approximately mid-July 2007 (July 30th);

American Home Mortgage announced that it was unable to borrow on its credit facilities and to fund its lending obligations of approximately \$300 million on July 30 and that it did not anticipate funding approximately \$450 to \$500 million on July 31. (July 31th);

American Home Mortgage filed for bankruptcy protection (August 6th);

Aegis Mortgage suspended loan originations (August 6) and files for bankruptcy protection (August 10th);

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HomeBanc filed for bankruptcy protection (August 10th);

NovaStar Financial suspended wholesale originations (August 17th) and sharply reduced retail originations (September 4th);

Countrywide Financial Corp., facing unprecedented disruptions to its funding operations, tapped \$11.5 billion credit line (August 16th); Bank of America invested \$2 billion in Countrywide (August 22th);

Capital One shut down its GreenPoint Mortgage subsidiary, cutting 1,900 jobs (August 20th);

Lehman Brothers announced the closing of its subprime subsidiary, BNC Mortgage LLC (August 22nd);

Nationstar Mortgage, the subprime unit of Fortress Investment Group, stopped all wholesale originations (September 21st);

HSBC closed one of its non-prime lending units, Decision One (September 24th);

Luminent Mortgage Capital Inc. stated that the fallout from the subprime mortgage crisis could cut the value of its investment portfolio and may lead to the loss of its real-estate investment trust status (September 26th);

Credit Suisse Group begins pruning its mortgage-backed securities unit by laying off 150 employees (September 26);

Morgan Stanley cut 600 positions related to its mortgage business (October 2nd); and

Bear Stearns cut 310 jobs by combining two of its mortgage units (October 3rd).

The combination of these events with the continued heavy repurchase demands from whole loan purchasers experienced during this period created a cycle beginning with a significant increase in the amount of distressed loans for sale in the market. This increase in loan supply reduced whole loan prices, providing a basis for warehouse line providers to mark down the collateral value of loans held in inventory and, as a result, to place margin calls on non-prime lenders. These increased margin calls resulted in more distressed sales which, in turn, put further downward pressure on whole loan sale prices, regenerating the cycle with escalating negative results.

All of these general market conditions may affect the performance of the mortgage loans originated by us and, even if they do not affect performance, have and may continue to adversely affect our common stock price.

We restructured our operations and temporarily suspended U.S. mortgage loan originations, and our resumed lending operations may not be profitable.

We require substantial cash to fund our mortgage loan originations, to pay our mortgage loan origination expenses and to hold our mortgage loans pending sale or securitization. Also, as a servicer of mortgage loans, we are required to advance delinquent principal and interest payments, unpaid property taxes, hazard insurance premiums, and foreclosure and foreclosure-related costs. While we maintain warehouse and other credit facilities that provide substantial financing for our operations, we must originate mortgage loans and sell or securitize our mortgage loan originations at a profit in order to maintain our credit facilities and successfully fund our operations over time.

Due to the turbulence in the non-prime mortgage industry, we have not been able to sell or securitize at a profit most of the mortgage loans we have originated throughout 2007. Accordingly, we made the decision to restructure our operations, beginning September 2007, to eliminate all retail lending operations, significantly downsize wholesale lending operations, and suspend substantially all U.S. lending unless and until market conditions return under which non-prime mortgage loans could again be originated and sold or securitized at a profit. On October 15, 2007, we resumed U.S. lending operations because we believe that, with the support of our new parent LoneStar, we can resume lending operations in a manner that will be beneficial over the long term. As a consequence, the survival of our downsized operations will be primarily dependent upon income derived from our servicing operations, our residual interests in previously securitized loans and our Canadian mortgage loan originations. There can, however, be no assurance that our resumption of U.S. lending operations will be successful or that our other sources of income— income derived from our servicing operations, our residual interests in previously securitized loans and our Canadian mortgage loan originations— will be sufficient to fund our operations going forward.

Our credit facilities are subject to margin calls based on the lender's opinion of the value of our related collateral. An unanticipated large margin call could severely harm our liquidity.

The financing we receive under our credit facilities depends in large part on the lenders' valuation of the collateral securing the financing. Each credit facility allows the lender to revalue the collateral at any time to values that the lender, in their discretion, considers to be market values. In the event that a lender determines that the value of the collateral has decreased, it may initiate a margin call requiring us to post additional collateral to cover the decrease. When we are subject to such a margin call, we must provide the lender with additional collateral or repay a portion of the outstanding borrowings with minimal notice. Any such margin call could harm our liquidity, results of operation, financial condition and business prospects. If the frequency, volume or size of margin calls increases significantly, it would have a material and adverse impact on our ability to continue as a going concern. Additionally, in order to obtain cash to satisfy a margin call, we may be required to liquidate assets at a disadvantageous time, which could cause us to incur further losses and adversely affect our results of operations and financial condition.

If we fail to comply with the requirements of our credit facilities, or obtain waivers of compliance, or if one or more lenders determines that we have suffered a material adverse change, the credit facilities may be terminated, all amounts advanced under the credit facilities may become immediately due and payable, and collateral pledged under the facilities may be subject to foreclosure.

All of our credit facilities contain requirements that we must comply with in order to maintain outstanding and further borrowings under the facilities. These requirements address, among other things:

minimum profitability, liquidity and net worth levels;

maximum indebtedness-to-net worth ratios;

asset quality and mortgage loan performance tests;

restrictions on indebtedness, investments and acquisitions; intercompany dividends; repurchase or redemption of capital stock; and mergers or consolidations or other changes of control;

mortgage loan attributes;

limits on time periods for holding mortgage loans;

loss of servicer ratings;

maximum cumulative losses;

financial reporting requirements, including timely filing of reports required under the Securities Exchange Act of 1934;

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

material adverse change restrictions.

If we fail to meet or satisfy any of these requirements or do not obtain waivers of compliance, we would be in default under these agreements and our lenders could elect to terminate the credit facility, declare all amounts outstanding under the agreements immediately due and payable, enforce their interests against collateral pledged under such agreements, and restrict our ability to make future borrowings.

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

Our inability to obtain additional or replacement sources of financing may substantially harm our business.

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Our ability to obtain additional sources of financing may be limited to the extent that we have pledged our mortgage loans, our servicing rights and advances, and our economic residual interests in previously securitized loans to warehouse and other credit facility providers. Additionally, on March 30, 2007, we pledged substantially all of our remaining unencumbered assets to secure a \$230 million loan from an affiliate of Farallon Capital Management, LLC. To the extent that we are not successful in maintaining, replacing or obtaining alternative financing sources on acceptable terms, our business may be significantly harmed.

Repurchases of defective mortgage loans such as loans that experience early payment defaults may harm our business.

In connection with the sale and securitization of our mortgage loans, we are required to make a variety of customary representations and warranties regarding our company and the mortgage loans. These representations and warranties address, among other things:

the timely payment of early payments due on the loan, typically the first one or two (an Early Payment Default);

fraud in the origination process;

compliance with laws;

regulations and underwriting standards;

the accuracy of information in the mortgage loan documents and mortgage loan file; and

the characteristics and enforceability of the mortgage loan.

With the exception of the Early Payment Default warranty, we are subject to these representations and warranties for the life of the mortgage loan.

If, after a mortgage loan is sold or securitized, a breach of any such representation or warranty is identified and asserted, we may be obligated to repurchase the mortgage loan and bear any associated loss directly, or we may be obligated to indemnify the purchaser or securitization trust against any such losses, either of which could reduce our cash available for operations and liquidity. During the years ended December 31, 2006 and 2005, mortgage loans repurchased totaled \$205.2 million and \$72.3 million, respectively, pursuant to these obligations. In late 2006 continuing into 2007, certain purchasers became more aggressive regarding the identification, notification and collection of repurchase requests to the Company. In addition, the number of mortgage loans that we have been required to repurchase has increased as a result of our merger with Aames, since we assumed their repurchase obligations upon the closing of the merger. During the eight months ended August 31, 2007, we repurchased approximately \$208 million in mortgage loans and paid \$67 million in cash settlements to eliminate the requirement to repurchase mortgage loans in the future from investors.

Once we repurchase a mortgage loan, we may either sell it or retain such loan as part of our portfolio and bear any associated losses. We seek to minimize such losses from defective mortgage loans by correcting flaws if possible and selling or re-selling such mortgage loans. If we sell such a loan, the sale would be at a discount, which could be quite severe. A mortgage loan that does not comply with these representations and warranties may take longer to sell, impact our ability to obtain third party financing for such mortgage loan, and be unsaleable or saleable only at a discount. We create allowances to provide for defective mortgage loans in our financial statements.

We cannot assure you that we have not and will not make mistakes and breach such representations and warranties, or that certain employees will not deliberately violate our lending policies. We cannot assure you that losses associated with defective mortgage loans will not harm our results of operations or financial condition.

We face steeply declining employee morale, and our inability to retain qualified employees could significantly harm our business.

As a result of the ongoing turbulence in the non-prime mortgage industry, our headcount has declined from approximately 4,200 at December 31, 2006 to approximately 1,000 following the completion of the restructuring we have implemented in September 2007. In light of the decision to suspend substantially all U.S. lending as part of the restructuring, it will be very difficult to motivate and retain the remaining sales personnel who expect to derive significant income from commissions and bonuses on closed loans. It will also be difficult to motivate and retain non-commissioned personnel who are faced with great uncertainty regarding their future employment and advancement prospects with the Company. The inability to retain or replace sufficient qualified personnel may jeopardize our ability to run our downsized operations or successfully resume U.S. lending operations should the opportunity arise.

We rely, to a significant degree, on a few key executives.

The Company's success is significantly reliant upon a few key individuals, including but not limited to, James Konrath, the Chairman and Chief Executive Officer, Joseph Lydon, the President and Chief Operating Officer, Stuart Marvin, the Executive Vice President, and Jeffrey Crawford, the Director of Operations.

None of the above mentioned executives are subject to employment contracts which would provide an incentive to the executives to remain at the Company. In addition, for the year ended December 31, 2006, many of the members of management, including these executives, had their incentive compensation reduced substantially from amounts historically paid or targeted for the year ended December 31, 2006.

Based upon the above, there can be no assurance that such executives, or other executives at the Company, will remain with the Company.

Ratings downgrades of our servicing operations and securitized bonds may make future securitizations more difficult and costly to execute, even if secondary mortgage market conditions become more favorable.

Our ability to complete securitizations of our mortgage loans will depend upon a number of factors in addition to market conditions, many of which are beyond our control, including the availability of credit enhancements to support the securities sold in securitizations, such as financial guarantee insurance, a senior subordinated structure or other means, and the performance of our mortgage loans previously held for investment. As a result of the ongoing turbulence within the non-prime mortgage industry, credit enhancement requirements for securitizations of non-prime mortgage loans have been significantly increased and may be further increased in the future. This generally has the effect of increasing the overall

expense of executing securitizations and reducing the earnings therefrom. Moreover, our ratings as a mortgage loan servicer have been downgraded in recent months and may be downgraded further, limiting our ability to act as servicer of our securitizations without a backup servicer. Also, the ratings of several tranches of our previously securitized bonds have been downgraded in recent months and further such downgrades may occur, adding to the difficulty of executing future securitizations. As a result of the foregoing, we cannot assure you, that we will be able to resume mortgage loan securitizations on terms that are favorable to us.

As a result of the merger with Aames, we acquired deferred tax assets that we may not be able to realize.

As a result of the acquisition of Aames, we acquired deferred tax assets. Based upon the ongoing turbulence in the non-prime mortgage industry, there can be no assurance that the Company will be able to achieve profitable operations in the future and therefore realize the value of certain deferred tax assets obtained in the acquisition of Aames. Based upon these events and circumstances, we established a valuation allowance against certain tax assets as of December 31, 2006.

As a result of our acquisition of Aames, our management has been and may continue to be distracted from their focus on our business and operations in order to attend to issues arising out of the acquisition and subsequent integration.

There is a significant degree of difficulty and management distraction inherent in the process of acquiring and integrating a business such as Aames. The acquisition and integration have caused and continues to cause an interruption of, or loss of momentum in, the activities of our business. Members of our senior management have devoted and may be required to continue to devote considerable amounts of time to the acquisition and integration process, which has decreased and may decrease the time have to manage our business and develop new strategies. If our senior management is not able to effectively manage the acquisition and integration process, or if any significant business activities are interrupted as a result of the acquisition and integration process, our business could suffer further.

Our use of repurchase agreements to borrow funds may give our lenders greater rights in the event that either we or a lender files for bankruptcy.

Historically, most of our warehouse lending facilities and the REIT's residual financing facilities have been structured as repurchase agreements. Our borrowings under repurchase agreements may qualify for special treatment under the Bankruptcy Code, giving the lenders the ability to avoid the automatic stay provisions of the Bankruptcy Code and to take possession of and liquidate our collateral under the repurchase agreements without delay in the event that we file for bankruptcy. Our business relies upon access to funds in order to originate mortgages. In the event of a bankruptcy filing and the lenders' seizure of the collateral securing our obligations to them, we would likely have great difficulty in obtaining replacement credit facilities because we would not have sufficient collateral to secure the loans we require to continue operating. Without such replacement credit, we would be unable to continue as a going concern. Furthermore, the special treatment of repurchase agreements under the Bankruptcy Code may make it difficult for us to recover our pledged assets in the event that a lender liquidates. Thus, the use of repurchase agreements exposes our pledged assets to risk in the event of a bankruptcy or other insolvency filing by either a lender or us.

The REIT is bound by certain covenants in connection with its Series A Preferred Shares, and if the REIT breaches such covenants, no dividends can be paid on the REIT's common shares which we hold, which may adversely affect our liquidity.

In connection with the issuance of the REIT's Series A Preferred Shares, the REIT agreed to be bound by the following covenants:

Commencing with the quarter ending December 31, 2004, the REIT was required to have on its balance sheet total shareholders equity, as of the end of each quarter and determined in accordance with accounting principles generally accepted in the United States of America, equal to at least \$50 million;

Commencing with the quarter ending December 31, 2004, the REIT was required to have on its balance sheet loans held for investment (generally defined as securitized loans and loans held for securitization), as of the end of each quarter and determined in accordance with accounting principles generally accepted in the United States of America, greater than or equal to \$2 billion; and

Commencing with the quarter ending December 31, 2005, the REIT was required, for the four fiscal quarters most recently ended, to have cumulative unencumbered cash flow (generally defined as earnings before interest expense, income tax expense, depreciation and amortization adjusted to exclude extraordinary gains or losses, gains (but not losses) from sales of assets outside the ordinary course of business and income from subsidiaries of the REIT to the extent that such subsidiaries are restricted by law or agreement

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from distributing such income to the REIT, except to the extent such income is actually distributed in a period) greater than or equal to six times the cumulative dividend required to be distributed to holders of the REIT's Series A Preferred Shares in those four quarters.

If the REIT is not in compliance with any of the foregoing covenants as of the end of any quarter and remains in default on one or more covenants as of the end of the following quarter, then no dividends are payable on the REIT's common shares until it is in compliance with all of the covenants as of the end of two successive quarters. At June 30, 2007, the REIT was in compliance with all of the foregoing covenants.

We own all of the REIT's common shares and rely heavily on the dividend received from the REIT on the common shares. If the REIT violates the covenants in connection with the Series A Preferred Shares, we will not be able to receive any dividends on our common shares of the REIT which will adversely affect our business and operations. In 2006, the aggregate dividend we received on the common shares of the REIT was approximately \$200 million.

Significant losses on the economic residual interests from securitizations that we retain in the REIT and its subsidiary will reduce our earnings, negatively affect our liquidity, and otherwise negatively affect our business.

The economic residual interests for securitizations that we retain in the REIT and its subsidiary are unrated and involve significant investment risk. By holding these economic residual interests from securitizations, we retain the first loss risk associated with the underlying pool of mortgage loans. As a result, the credit performance and prepayment rates of the non-prime loans underlying these residual interests directly affect our returns on these residual interests. Significant realized losses from our economic residual interests could harm our results of operations and financial condition.

We are in the business of originating non-prime mortgage loans which generally have higher delinquency and default rates than prime mortgage loans. If we do not adequately underwrite and price for this risk, our business could be harmed.

We are in the business of originating, financing, selling, securitizing and servicing non-prime mortgage loans. Non-prime mortgage loans generally have higher delinquency and default rates than prime mortgage loans. Delinquency interrupts the flow of projected interest income from a mortgage loan and a default can ultimately lead to a loss if the net realizable value of the real property securing the mortgage loan is insufficient to cover the principal and interest due on the mortgage loan. Also, our cost of financing and servicing a delinquent or defaulted mortgage loan is generally higher than for a performing mortgage loan. We bear the risk of delinquency and default on mortgage loans beginning when we originate them until we sell them and we continue to bear the risk of delinquency and default after we securitize mortgage loans or sell mortgage loans with a retained interest. Mortgage loans that become delinquent prior to sale or securitization may become unsaleable or saleable only at a discount, and the longer we hold mortgage loans prior to sale or securitization, the greater the chance we will bear the costs associated with the mortgage loans' delinquency. Factors that may increase the time held prior to sale or securitization include the time required to accumulate mortgage loans for securitizations or sales of large pools of mortgage loans, the amount and timing of third-party due diligence in connection with sales or securitizations, defects in the mortgage loans and the investor demand for whole loan pools and securitization debt.

We also reacquire the risks of delinquency and default for mortgage loans that we are obligated to repurchase. Repurchase obligations are typically triggered in mortgage loan sale transactions if an Early Payment Default occurs on the mortgage loan after sale or in any sale or securitization if the mortgage loan materially violates our representations or warranties.

If we experience higher-than-expected levels of delinquency or default in pools of mortgage loans that we service, we may lose our servicing rights, which would result in a loss of future servicing income and may damage our reputation as a mortgage loan servicer.

We attempt to manage these risks with risk-based mortgage loan pricing and appropriate underwriting policies and mortgage loan collection methods. However, if such policies and methods are insufficient to control our delinquency and default risks and do not result in appropriate mortgage loan pricing and collecting, our business, financial condition, liquidity and results of operations could be significantly harmed. Our total delinquency rate (30 or more days past due, including mortgage loans in foreclosure and converted into real estate owned) for our servicing portfolio was 11.7% at June 30, 2007. Historically, our delinquency rate has increased, and we anticipate an increase in the future, as the mortgage loans in our portfolio age.

We may change our policies in ways that harm our financial condition or results of operations.

Our investment and financing policies and our policies with respect to other activities, including our growth, debt capitalization, distributions, REIT status of the REIT and operating policies are determined by our board of directors. Our board of directors may change these policies at any time without a vote of our stockholders. A change in these policies might harm our financial condition, results of operations or business prospects.

Our accounting policies and methods are fundamental to how we report our financial condition and results of operations, and they may require management to make estimates about matters that are inherently uncertain.

We have identified several accounting policies as being critical to the presentation of our financial condition and results of operations because they require management to make particularly subjective or complex judgments about matters that are inherently uncertain and because of the likelihood that materially different amounts would be recorded under different conditions or using different assumptions. These critical accounting policies relate to, without limitation, securitizations structured as financings, allowance for losses on mortgage loans held for investment, valuation adjustments for mortgage loans held for sale to the lower of cost or market (LOCOM), allowance for repurchase losses, gain on sale of mortgage loans, income taxes and derivative instruments designated and documented as hedges. Because of the inherent uncertainty of the estimates associated with these critical accounting policies, we cannot provide any assurance that we will not make significant subsequent adjustments to the related amounts recorded.

We face intense competition that could adversely impact our market share and our revenues.

We face intense competition from finance and mortgage banking companies, from Internet-based lending companies where entry barriers are relatively low, and from traditional bank and thrift lenders that have entered the non-prime mortgage industry. Some of our competitors are much larger, have better name recognition, and have far greater financial and other resources than us.

The government-sponsored entities Fannie Mae and Freddie Mac are also participants in the non-prime mortgage industry. These government-sponsored entities have a size and cost-of-funds advantage that allows them to purchase mortgage loans with lower rates or fees than we are willing to offer. Continued expansion of the government sponsored entities involvement in the market to originate or purchase non-prime mortgage loans could continue to change the dynamics of the industry by virtue of their sheer size, pricing power and the inherent advantages of a government charter. In addition, if as a result of their purchasing practices, these government-sponsored entities experience significantly higher-than-expected losses, such losses could adversely affect the overall investor perception of the non-prime mortgage industry. The recent announcement by Freddie Mac that it is curtailing its purchase of certain non-prime mortgages could also adversely affect investor perception of the non-prime mortgage industry.

Competition in the industry can take many forms, including interest rates and costs of a mortgage loan, less stringent underwriting standards, offering of mortgage loan products which we do not offer, convenience in obtaining a mortgage loan, customer service, amount and term of a mortgage loan and marketing and distribution channels. The need to maintain mortgage loan volume in this competitive environment creates a risk of price competition in the non-prime mortgage industry. Price competition could prevent us from raising rates in response to a rising cost of funds or cause us to lower the interest rates that we charge borrowers, which could adversely impact our profitability and lower the value of our mortgage loans. If our competitors adopt less stringent underwriting standards, we will be pressured to do so as well, which would result in greater mortgage loan risk without compensatory pricing. If we do not relax underwriting standards in response to our competitors, we may lose market share. Any increase in these pricing and underwriting pressures could reduce the volume of our mortgage loan originations and sales and significantly harm our business, financial condition, liquidity and results of operations. The risks described in this paragraph have already contributed significantly to the current condition of the non-prime mortgage industry.

Any future economic slowdown could increase delinquencies, defaults and foreclosures and impair our ability to originate mortgage loans.

Any future economic slowdown or recession may be accompanied by decreased demand for consumer credit, decreased real estate values, and increased rates of delinquencies, defaults and foreclosures. Any material decline in real estate values would increase the mortgage loan-to-value ratios (LTVs) on mortgage loans that we hold pending sale and mortgage loans in which we have a residual or retained interest, weaken our collateral coverage and increase the possibility and severity of a loss if a borrower defaults. We are in the business of originating mortgage loans to borrowers who make little or no down payment, resulting in higher LTVs. A lack of equity in the home may reduce the incentive a borrower has to meet his payment obligations during periods of financial hardship, which might result in higher delinquencies, defaults and foreclosures. These factors would impair our ability to originate mortgage loans and increase our losses on mortgage loans in which we have a residual or retained interest. In addition, mortgage loans we may originate during an economic slowdown may not be as valuable to us because potential purchasers of our mortgage loans might reduce the premiums they pay for the

mortgage loans to compensate for any increased risks arising during such periods. Any sustained increase in delinquencies, defaults or foreclosures is likely to significantly harm the pricing of any future mortgage loan sales and securitizations and also our ability to finance mortgage loan originations. The risks described in this paragraph have already contributed significantly to the current condition of the non-prime mortgage industry.

A future increase in interest rates could harm future mortgage loan origination volumes, and result in an increase in delinquency, default and foreclosure rates and a reduction in the value of, and income from, our mortgage loans.

The following are some of the risks we face related to an increase in interest rates:

A substantial and sustained increase in interest rates could harm our ability to originate mortgage loans because refinancing an existing mortgage loan would be less attractive and qualifying for a purchase mortgage loan may be more difficult.

Existing borrowers with adjustable-rate mortgages or higher risk mortgage loan products may incur higher monthly payments as the interest rate increases, or experience higher delinquency and default rates.

If prevailing interest rates increase after we fund a mortgage loan, the value that we would receive upon the sale or securitization of the mortgage loan decreases.

The cost of financing our mortgage loans prior to sale or securitization is based primarily upon the London Inter-Bank Offered Rate (LIBOR). The interest rates we charge on our mortgage loans are based, in part, upon prevailing interest rates at the time of origination, and the interest rates on all of our mortgage loans are fixed for at least the first six months. If LIBOR increases after the time of mortgage loan origination, our net interest income which represents the difference between the interest rates we receive on our mortgage loans pending sale or securitization and our LIBOR-based cost of financing such mortgage loans will be reduced. The weighted average cost of financing our mortgage loans, prior to sale or securitization, was 7.21% during the quarter ended June 30, 2007.

When we securitize mortgage loans, the income we receive from the economic residual interests we retain are also based on LIBOR to the extent the underlying mortgage loans have an adjustable interest rate. This is because the income we receive from these interests is based on the difference between the fixed rates payable on the mortgage loans for the initial fixed-rate periods, and an adjustable LIBOR-based yield payable to the senior security holders. We also have interest rate risk when the mortgage loans become adjustable after their initial fixed-rate periods. This is due to the mortgage loan rates resetting every six months, subject to various caps and floors, versus the monthly reset on the rate passed through to the holders of the securitization bonds that is not typically subject to any caps or floors.

Accordingly, our business, financial condition, liquidity and results of operations may be significantly harmed as a result of increased interest rates.

Our business may be significantly harmed by a slowdown in the economy or a natural disaster in the states of California or Florida, where we conduct a significant amount of business.

A significant portion of the mortgage loans we have originated, purchased or serviced has been secured by properties in California and Florida. During the quarter ended June 30, 2007, 15% and 16% of the principal balance of the mortgage loans we originated were collateralized by properties located in California and Florida, respectively. At June 30, 2007, 17% and 14% of the unpaid principal balance of mortgage loans we serviced were collateralized by properties located in California and Florida, respectively. 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 in these states. This, in turn, would increase the risk of delinquency, default or foreclosure on mortgage loans in our portfolio or that we have sold to others. This could restrict our ability to originate, sell, or securitize mortgage loans, and significantly harm our business, financial condition, liquidity and results of operations.

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

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We use various derivative financial instruments to provide a level of protection against interest rate risks, but no hedging strategy can protect us completely. When rates change, we expect to record a gain or loss on derivatives which would be offset by an inverse change in the value of mortgage loans held for sale and the amount of interest expense paid related to our securitization bonds. We cannot assure you, however, that our use of derivatives will offset the risks related to changes in interest rates. There have been periods, and it is likely that there will be periods in the future, during which we will not have offsetting gains or losses in mortgage loan values after accounting for our derivative financial instruments. The derivative financial instruments we select may not have the effect of reducing our interest rate risk. In addition, the nature and

timing of hedging transactions may influence the effectiveness of these strategies. Poorly designed strategies, improperly executed and recorded transactions or inaccurate assumptions could actually increase our risk and losses. In addition, hedging strategies involve transaction and other costs. We cannot assure you that our hedging strategy and the derivatives that we use will adequately offset the risk of interest rate volatility or that our hedging transactions will not result in losses.

Our rights to cash flow from our securitized mortgage loans are subordinate to senior interests and may fail to generate any cash flow for us if the mortgage loan payment stream only generates enough cash flow to pay the senior interest holders.

As part of the credit enhancement for our securitizations, the net cash flow that we receive from the economic residual interests that we retain generally represents the excess of amounts, if any, generated by the underlying mortgage loans over the amounts required to be paid to the senior security holders. This excess amount is also calculated after deduction of servicing fees and any other specified expenses related to the securitization. These excess amounts are derived from, and are affected by, the interplay of several factors, including:

the extent to which the interest rates of the mortgage loans exceed the interest rates payable to the senior security holders;

the level of losses and delinquencies experienced on the underlying mortgage loans; and

the extent to which the underlying mortgage loans are prepaid by borrowers in advance of scheduled maturities.

During the six months ended June 30, 2007, we completed securitizations of mortgage loans totaling \$0.8 billion. During each year ended December 31, 2006, 2005 and 2004, we completed securitizations of mortgage loans totaling \$2.4 billion, \$4.2 billion and \$3.3 billion, respectively. Any combination of the factors listed above may reduce the income we receive from and the value of our economic residual interests.

If we do not manage the size of operations effectively, our financial performance could be harmed.

Prior to 2007, we experienced rapid growth that placed certain pressures on our management, administrative, operational and financial infrastructure. In addition to growth by direct expansion, we grew by acquiring the stock or assets of other mortgage companies. For example, our acquisition of Aames added approximately 1,450 employees upon its completion in October 2006. As of December 31, 2006, we had approximately 4,200 employees (1,177 of which were attributable to our acquisition of Aames). Many of these employees had very limited experience with us and a limited understanding of our systems and controls. In connection with the restructuring implemented in September 2007, we downsized to approximately 1,000 employees, and we may implement additional reductions in our number of employees and other cost-saving measures. In light of these recent challenges, we cannot assure you that we will be able to:

meet our capital needs;

retain qualified employees;

size our systems effectively;

allocate our human resources optimally;

satisfactorily perform our servicing obligations; or

effectively integrate the components of any businesses that we may acquire in our effort to achieve growth.

The failure to manage the size of our operations would significantly harm our business, financial condition, liquidity and results of operations.

Failure to keep pace with technological changes or an interruption in, or breach of, our information systems may further harm our business.

We rely heavily upon communications and information systems to conduct our business. The intense competition in the non-prime mortgage industry has led to rapid technological developments, evolving industry standards and frequent releases of new products and enhancements. As mortgage products are offered more widely through alternative distribution channels, such as the Internet, we may be required to make significant changes to our current retail and wholesale structure and information and technology systems to compete effectively. Our inability to continue enhancing our current Internet capabilities, or to adapt to other technological changes in the industry, could significantly harm our business, financial condition, liquidity and results of operations. In addition, we rely on software and other technology-based programs to gather and analyze competitive and other data from the marketplace. Problems with our technology or inability to implement technological changes may, therefore, result in delayed detection of market trends and conditions. Also, any failure, interruption or breach in the security of our information systems or the third-party information systems on which we rely could cause underwriting or other delays and could result in fewer mortgage loan applications being received, slower

processing of applications and reduced efficiency in mortgage loan servicing. We cannot assure you that such failures or interruptions will not occur, or if they do occur that they will be adequately addressed by us or the third parties on which we rely. The occurrence of any failures or interruptions could significantly harm our business.

The success and growth of our business will be affected by our ability to adapt to and implement technological changes.

The ability to effectively interface with brokers, borrowers and other third parties in the mortgage loan origination process, and efficiently process mortgage loan applications and closings strongly affects the ability to originate mortgage loans. The origination process is becoming more dependent upon technological advancement, such as the ability to process applications over the Internet, accept electronic signatures, provide status updates instantly, and other customer-expected conveniences. In addition, competition and increasing regulation may increase our reliance on technology as a means to improve efficiency. Implementing this new technology and becoming proficient with it may also require significant capital expenditures. We will have to keep pace with technological developments to become and remain competitive.

We may not be able to successfully resume our wholesale lending operations if we are unable to re-establish our network of independent brokers.

Historically, a significant majority of our originations of mortgage loans have come from independent brokers. During 2006, 85% of our mortgage loan originations were originated through our broker network. Our brokers are not contractually obligated to do business with us. Further, our competitors also have relationships with our brokers and actively compete with us for their business. Accordingly, there can be no assurance that we will be able to re-establish our broker relationships in connection with our resumption of wholesale lending operations, thereby jeopardizing the success of such resumption.

Our financial results fluctuate as a result of seasonality and other timing factors, which makes it difficult to predict our future performance and may affect the price of our common stock.

Our business is generally subject to seasonal trends. These trends reflect the general pattern of housing sales, which typically peak during the spring and summer seasons. Our quarterly operating results have fluctuated in the past and are expected to fluctuate in the future, reflecting, in part, the seasonality of the industry. Further, if the closing of a sale of mortgage loans is postponed, the recognition of gain from the sale is also postponed. If such a delay causes us to recognize income in the next quarter, our results of operations for the previous quarter could be significantly depressed.

We are subject to losses due to fraudulent and negligent acts on the part of mortgage loan applicants, mortgage brokers, other vendors and our employees.

When we originate mortgage loans, we rely heavily upon information supplied by third parties including the information contained in the mortgage loan application, property appraisal, title information and employment and income documentation. If any of this information is intentionally or negligently misrepresented and such misrepresentation is not detected prior to mortgage loan funding, the value of the mortgage loan may be significantly lower than expected. Whether a misrepresentation is made by the mortgage loan applicant, the mortgage broker, another third party or one of our own employees, we generally bear the risk of loss associated with the misrepresentation. If a mortgage loan is subject to a material misrepresentation, we are typically unable to sell or are required to repurchase the loan if it was sold prior to detection of the misrepresentation. Even though we may have rights against persons and entities who made or knew about the misrepresentation, such persons and entities are often difficult to locate and it is often difficult to collect any monetary losses that we have suffered as a result of their actions.

We have controls and processes designed to help us identify misrepresented information in our mortgage loan origination operations. We cannot assure you, however, that we have detected or will detect all misrepresented information in our mortgage loan originations. We are subject to losses due to fraudulent and negligent acts in other parts of our operations. If we experience or detect a significant number of such fraudulent or negligent acts, our business, financial condition, liquidity and results of operations would be significantly harmed.

We may be required to conform to the standards of the January 2006 Ameriquest settlement, which could harm our business.

In January 2006, ACC Capital Holding Corporation and its subsidiaries Ameriquest Mortgage Company, Town & Country Credit Corporation and AMC Mortgage Services Inc., formerly known as Bedford Home Loans, which we refer to collectively as Ameriquest, reached a settlement with various state Attorneys General resolving some of the regulatory complaints and consumer claims made against Ameriquest relating to alleged predatory home mortgage lending. By the terms of the settlement, the second largest federal consumer protection settlement in history, Ameriquest agreed to implement certain new standards and to pay \$325 million to the states, with most of the money to be used to pay restitution to consumers who obtained mortgage loans from Ameriquest between January 1999 and December 2005.

In the settlement, Ameriquest denied all allegations but agreed to implement certain new standards and practices meant to prevent a recurrence of its alleged abuses and unfair and deceptive practices. Many of the settlement's requirements far exceed any express requirements of existing lending laws. Although we believe our historical controls and practices have operated effectively to mitigate the risk of the abuses alleged in the Ameriquest settlement, in many cases our controls and policies are not identical to those prescribed by the Ameriquest settlement. However, some Attorneys General have made public statements that the conduct required by the Ameriquest settlement should be seen as new standards applicable to the entire industry and that they may pursue actions against lenders who do not adhere to the new standards. If the Attorneys General seek to apply these standards to the entire industry or our company in particular, some of our own practices could be called into question and our revenues, business, results of operations and profitability could be harmed. In addition, if it becomes accepted practice that settlements entered with Attorneys General establish new standards for the industry as a whole and supersede existing express legislative requirements, the standards by which we are governed will become less predictable and the risks associated with our business will increase.

Various legal proceedings are pending and more may be filed in the future which could adversely affect our financial condition or results of operations.

We are named as a defendant in a number of lawsuits seeking significant monetary damages. See Legal Proceedings under Item 1 for a description of material legal actions in which we are involved.

Additional litigation may be filed against us or disputes may arise in the future concerning these or other business practices. In addition, lawsuits have been filed, and other lawsuits may be filed in the future, against our competitors and other businesses, and although we are not a party to such litigation, the results of such lawsuits may create additional risks for, or impose additional costs or limitations on, our business operations.

As courts resolve individual or class action litigation related to our industry, regulations and standards could emerge necessitating material increases in our costs of doing business or preventing us from participating in certain business activities in which we currently engage or may wish to resume in the future. The outcome of litigation and other legal matters is always uncertain. One or more legal matters could result in losses material to our financial condition, results of operations, business and profitability.

If the prepayment rates for our mortgage loans are different than expected, our results of operations may be significantly harmed.

When a borrower pays off a mortgage loan prior to the mortgage loan's scheduled maturity, the impact on us depends upon when such payoff or prepayment occurs. Our prepayment losses generally occur after we sell or securitize our mortgage loans and the extent of our losses depends on when the prepayment occurs. If the prepayment occurs:

within 12 to 18 months following a whole mortgage loan sale, we may have to reimburse the purchaser for all or a portion of the premium paid by the purchaser for the mortgage loan, resulting in a loss of or reduction in our profit on the mortgage loan; or

after we have securitized the mortgage loan, we lose the future income from that mortgage loan.

Prepayment rates on mortgage loans vary from time to time and tend to increase during periods of declining interest rates. Of the securitized mortgage loans we serviced during the quarter ended June 30, 2007, 28% were prepaid. We seek to minimize our prepayment risk through a variety of means, including originating a significant portion of mortgage loans with prepayment penalties with terms of two to five years. No strategy, however, can completely insulate us from prepayment risks, whether arising from the effects of interest rate changes or otherwise. See Statutory and Regulatory Risks below for a discussion of statutes related to prepayment penalties.

Our interest-only mortgage loans may have a higher risk of default than our fully-amortizing mortgage loans and, therefore, may be considered less valuable than other types of mortgage loans in the sales and securitization process.

Our 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. During the quarter ended June 30, 2007, originations of interest-only mortgage loans totaled \$168.3 million, or 10.0%, of total originations. The interest-only feature may reduce the likelihood of prepayment during the interest-only period due to the smaller monthly payments relative to a fully-amortizing mortgage loan. However, upon expiration of the interest-only payment, the borrower's payment will increase to cover the fully amortizing payment. The adjustment to the higher payment amount increases the risk that the borrower will default or prepay the mortgage loan. Because no principal payments may be made on such mortgage loans for an extended period following origination, if the borrower defaults, the unpaid principal balance of the related mortgage loan will be greater than otherwise would be the case, increasing the risk of loss in that situation. For those reasons, among others, these interest-only mortgage loans may be less valuable in the secondary market and may result in lesser proceeds to us when sold or securitized as compared to fully amortizing mortgage loans.

Decreasing home prices or increasing interest rates may impair future earnings from cash-out refinancings.

During the quarter ended June 30, 2007, approximately 77% of our mortgage loan production volume consisted of cash-out refinancings. A substantial and sustained increase in interest rates could significantly reduce the number of borrowers who would qualify or elect to pursue a cash-out refinancing and result in a decline in that origination source. Similarly, decreasing home prices reduce the amount of equity available to be borrowed against in cash-out refinancings and could result in a decrease in mortgage loan production volume from that origination source. Therefore, reliance on cash-out refinancings as a significant source of origination volume would subject us to risks that could harm our results of operations, financial condition and business prospects.

If many of our borrowers become subject to the Servicemembers Civil Relief Act of 2003, our cash flows from our residual securities and our securitizations structured as financings may be harmed.

Under the Servicemembers Civil Relief Act, which in 2003 re-enacted the Soldiers and Sailors Civil Relief Act of 1940 (the Act), a borrower who enters military service after the origination of the borrower's mortgage loan generally may not be charged interest above an annual rate of 6% during the period of the borrower's active duty status. The Act also applies to a borrower who was on reserve status and is called to active duty after origination of the mortgage loan. A prolonged, significant military mobilization as part of the war on terrorism or the war in Iraq could increase the number of the borrowers in our securitized pools who are subject to the Act and thereby reduce the interest payments collected from those borrowers. To the extent the number of borrowers subject to the Act is significant, the cash flows we receive from mortgage loans underlying the securitizations in which we have retained economic residual interests would be reduced, which could cause us to reduce the carrying value of our residual interests and could decrease our earnings. In addition, the Act imposes limitations that would impair the ability of the servicer to foreclose on an affected mortgage loan during the borrower's period of active duty status, and, under certain circumstances, during an additional three month period thereafter. Any such reduction in our cash flows or impairment of our ability to exercise our rights that would otherwise be available could harm our results of operations, financial condition and business prospects.

We are exposed to environmental liabilities, with respect to properties that we take title to upon foreclosure, that could increase our costs of doing business and harm our results of operations.

In the course of our servicing activities, we may foreclose and take title to residential properties and become subject to environmental liabilities with respect to those properties. We may be held liable to a governmental entity or to third parties for property damage, personal injury, investigation and clean-up costs incurred by these parties in connection with environmental contamination, or may be required to investigate or clean up hazardous or toxic substances or chemical releases at a property. The costs associated with investigation or remediation activities could be substantial. Moreover, as the owner or former owner of a contaminated site, we may be subject to common law claims by third parties based upon damages and costs resulting from environmental contamination emanating from the property. If we ever become subject to significant environmental liabilities, our business, financial condition, liquidity and results of operations would be significantly harmed.

Statutory and Regulatory Risks

The scope of our operations exposes us to risks of noncompliance with an increasing and inconsistent body of complex laws and regulations at the federal, state and local levels.

Because our business is set up to originate mortgage loans in all 50 states, in the District of Columbia and Canada, when we originate mortgage loans, we must comply with the laws and regulations, as well as judicial and administrative decisions, of all of these jurisdictions, as well as an extensive body of federal and international laws and regulations. The volume of new or modified laws and regulations has increased in recent years, and, in addition, individual cities and counties have begun to enact laws that restrict non-prime mortgage loan origination activities in those cities and counties. The laws and regulations of each of these jurisdictions are different, complex and, in some cases, in direct conflict with each other. As this proliferation of laws and regulations continues, it may be more difficult to comprehensively identify, to accurately interpret and to properly program our technology systems and effectively train our personnel with respect to all of these laws and regulations, thereby potentially increasing our exposure to the risks of noncompliance with these laws and regulations.

In light of the recent challenges in the mortgage industry, numerous legislative and regulatory proposals have been offered or enacted at the federal, state, and local government levels to address perceived market failures, address abusive lending practices, and restrict loan products, terms and conditions. For example at the federal level, the federal banking agencies published *Interagency Guidance on Nontraditional Product Risks* on October 4, 2006 and a *Statement on Subprime*

Lending on June 29, 2007. At the state level, the Conference of State Bank Supervisors (CSBS) and the American Association of Residential Mortgage Regulators (AARMR) issued *Guidance on Nontraditional Mortgage Product Risks* on November 14, 2006 and, on July 17, 2007, the CSBS, AARMR and the National Association of Consumer Credit Administrators issued a *Statement on Subprime Mortgage Lending*, each of which guidance documents are intended to substantially mirror the federal guidance. More than three dozen states have adopted in some fashion the *Guidance on Nontraditional Mortgage Product Risks* and the CSBS has asserted that 26 states are prepared to adopt on an expedited basis the *Statement on Subprime Mortgage Lending*.

In addition, government enforcement actions and private litigation may increase given the current scrutiny of the industry. These developments could, among other things, limit the range of loan products, reduce the pool of applicants who are eligible to obtain loans and restrict the volume and profitability of loan origination, investment and servicing activities, in addition to increasing exposure to risks of noncompliance with governing laws and regulations. As a result, these developments could have a material adverse impact on our results of operations, financial condition and business prospects.

In addition, recently enacted and changed laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, new Securities and Exchange Commission regulations and stock exchange rules, are creating uncertainties for companies like ours. These new or changed laws, regulations and standards are subject to varying interpretations due, in many cases, to their lack of specificity. As their applications evolve over time and new guidance is provided by regulatory and governing bodies, we may incur higher costs of compliance resulting from ongoing revisions to our disclosure and governance practices.

Our failure to comply with these laws can lead to:

civil and criminal liability;

loss of approved status;

demands for indemnification or mortgage loan repurchases from purchasers of our mortgage loans;

class action lawsuits;

administrative enforcement actions; or

delisting of our shares from securities markets.

Stockholder refusal to comply with regulatory requirements may interfere with our ability to do business in certain states.

Some states in which we operate may impose regulatory requirements on our officers and directors and persons holding certain amounts, usually 10% or more, of our common stock. If any person holding such an amount of our stock fails to meet or refuses to comply with a state's applicable regulatory requirements for mortgage lending, we could lose our authority to conduct business in that state.

We may be subject to fines or other penalties based upon the conduct of our independent brokers.

The mortgage brokers which are the source of wholesale mortgage loan originations are subject to legal obligations which are parallel to, but separate from, the legal obligations that we are subject to as a lender. While these laws may not explicitly hold the originating lenders responsible for the legal violations of mortgage brokers, federal and state agencies have increasingly sought to impose such assignee liability.

For example, the United States Federal Trade Commission (FTC) entered into a settlement agreement with a mortgage lender in which the FTC characterized a broker that had placed all of its mortgage loan production with a single lender as the agent of the lender. The FTC imposed a fine on the lender in part because, as principal, the lender was legally responsible for the mortgage broker's unfair and deceptive acts and practices. Also, the United States Justice Department in the past has sought to hold a non-prime mortgage lender responsible for the pricing practices of its mortgage brokers, alleging that the mortgage lender was directly responsible for the total fees and charges paid by the borrower under the Fair

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Housing Act even if the lender neither dictated what the mortgage broker could charge nor kept the money for its own account. Accordingly, we may be subject to fines or other penalties based upon the conduct of our independent mortgage brokers.

The increasing number of federal, state and local anti-predatory lending laws may restrict our ability to originate, or increase our risk of liability with respect to, certain mortgage loans and could increase our cost of doing business.

In recent years, several federal, state and local laws, rules and regulations have been adopted, or are under consideration, that are intended to eliminate so-called predatory lending practices. These laws, rules and regulations impose certain restrictions on mortgage loans on which certain points and fees or the annual percentage rate (APR) exceeds

specified thresholds, commonly referred to as high cost mortgage loans. Some of these restrictions expose a lender to risks of litigation and regulatory sanction no matter how carefully a mortgage loan is underwritten. In addition, an increasing number of these laws, rules and regulations seek to impose liability for violations on purchasers of mortgage loans, regardless of whether a purchaser knew of or participated in the violation.

We have generally avoided and will continue to avoid originating high cost mortgage loans because the rating agencies generally will not rate securities backed by such mortgage loans, and the companies that buy our mortgage loans and/or provide financing for our mortgage loan origination operations generally do not want to buy or finance such mortgage loans. The continued enactment or adoption of these laws, rules and regulations may prevent us from making certain mortgage loans that we would otherwise make, may cause us to cease operations in certain jurisdictions altogether and may cause us to reduce the APR or the points and fees on mortgage loans that we do make. In addition, the difficulty of managing the risks presented by these laws, rules and regulations may decrease the availability of warehouse financing and the overall demand for non-prime mortgage loans, making it difficult to fund, sell or securitize any of our mortgage loans. If we decide to relax our restrictions on mortgage loans subject to these laws, rules and regulations, we will be subject to greater risks for actual or perceived non-compliance with such laws, rules and regulations, including demands for indemnification or mortgage loan repurchases from our lenders and mortgage loan purchasers, class action lawsuits, increased defenses to foreclosure of individual mortgage loans in default, individual claims for significant monetary damages, and administrative enforcement actions. If nothing else, the growing number of these laws, rules and regulations will increase our cost of doing business, as we are required to develop systems and procedures to ensure that we do not violate any aspect of these new requirements. Any of the foregoing could significantly harm our business, financial condition, liquidity and results of operations.

Risk Factors Related to the Merger

Our business may be adversely impacted by our merger with Lone Star.

We have spent significant time and money consummating our merger with Lone Star. There are uncertainties and other factors that may affect our business subsequent to the merger, including:

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

potential difficulties for our employee retention as a result of the merger; and

the effect of the merger on our customer relationships, operating results and business generally.

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

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

ITEM 4. Controls and Procedures

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures. Accredited maintains disclosure controls and procedures that are designed to provide reasonable assurance that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

Under the supervision and with the participation of our management, including our principal executive officer and our principal financial officer, we conducted an evaluation of the effectiveness of our disclosure controls and procedures, as defined under Exchange Act Rule 13a-15(e). Based on this evaluation, our principal executive officer and our principal financial officer concluded that, as of June 30, 2007, our disclosure controls and procedures were not effective because of the identification of material weaknesses in our internal controls over financial reporting as of June 30, 2007, relating to the application of U.S. generally accepted accounting principles relating to the merger of Aames Investment Corporation as discussed in Part II, Item 9A. Controls and Procedures in Form 10-K for the year ended December 31, 2006.

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As of the filing date of this report, the Company has not fully remediated the material weaknesses in the Company's internal controls over financial reporting as of December 31, 2006. However, during 2007, management will take a number of steps that it believes will impact the effectiveness of our internal control over our financial reporting including the following:

For any future business combinations, management will take steps to improve the analysis of the impact to resources, training, education, documentation and accounting reviews to ensure that all relevant internal personnel involved understand and interpret proper accounting principles relating to purchase accounting. In addition, the Company anticipates focusing additional resources on accounting for hedge activities.

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

PART II

ITEM 1. Legal Proceedings

See Note 14 to the Notes to Unaudited Consolidated Financial Statements.

ITEM 1A. Risk Factors

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

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

None.

ITEM 3. Defaults Upon Senior Securities

None.

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

None.

ITEM 5. Other Information

None.

ITEM 6. Exhibits

For a list of exhibits filed with this Quarterly Report on Form 10-Q, refer to the Exhibit Index beginning on page 90.

SIGNATURES

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

Dated: October 19, 2007

ACCREDITED HOME LENDERS HOLDING CO.

BY: */s/ JAMES A. KONRATH*
James A. Konrath
Chairman of the Board and Chief Executive Officer

(Principal Executive Officer)

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

EXHIBIT INDEX

- 2.1⁽¹⁾ Agreement and Plan of Merger, dated as of June 4, 2007, by and among LSF5 Accredited Investments, LLC, LSF5 Accredited Merger Co., Inc. and the Company.
- 2.2⁽²⁾ First Amendment to Agreement and Plan of Merger, dated as of June 15, 2007, by and among the Company, LSF5 Accredited Investments, LLC, and LSF5 Accredited Merger Co., Inc.
- 2.3⁽³⁾ Second Amendment to Agreement and Plan of Merger, dated as of September 18, 2007, by and among the Company, LSF5 Accredited Investments, LLC, and LSF5 Accredited Merger Co., Inc.
- 3.1⁽⁴⁾ Amended and Restated Certificate of Incorporation of the Registrant.
- 3.2⁽⁴⁾ Amended and Restated Bylaws of the Registrant.
- 10.1 Deferred Compensation Plan
- 31.1 Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350)
- 32.2 Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350)

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- (1) Incorporated by Reference to the Company's Current Report on Form 8-K (File No. 000-32275) dated June 4, 2007.
 - (2) Incorporated by Reference to the Company's Current Report on Form 8-K (File No. 001-32275) dated June 15, 2007.
 - (3) Incorporated by Reference to the Company's Current Report on Form 8-K (File No. 001-32275) dated September 20, 2007.
 - (4) Incorporated by Reference to the Company's Current Report on Form 8-K (File No. 001-32275) dated October 12, 2007.