Accredited Mortgage Loan REIT Trust
Form 10-Q
August 09, 2006
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 30, 2006

or

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from __________ to __________

Commission File Number 001-32276

ACCREDITED MORTGAGE LOAN REIT TRUST(1)

(Exact name of registrant as specified in its charter)

Maryland	**35-2231035**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

15090 Avenue of Science

San Diego, California 92128

(Address of principal executive offices) (Zip Code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x 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 x

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

The number of outstanding shares of the registrant s common stock as of August 4, 2006 was 100,000.

(1) See explanatory note.

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EXPLANATORY NOTE

Accredited Mortgage Loan REIT Trust (the REIT) is an indirect subsidiary of Accredited Home Lenders Holding Co. (Accredited), a company that files annual, quarterly and other reports with the Securities and Exchange Commission (the SEC) pursuant to the Securities Exchange Act of 1934, as amended (the Exchange Act). All of the REIT s outstanding common shares are owned by Accredited Home Lenders, Inc., a wholly-owned subsidiary of Accredited (AHL). As of the date of this report, the only publicly traded securities of the REIT are the REIT s 9.75% Series A Perpetual Cumulative Preferred Shares, payments in respect of which are fully and unconditionally guaranteed by Accredited. In reliance on Rule 12h-5 under the Exchange Act, the REIT did not file reports pursuant to the Exchange Act prior to March 2005. In connection therewith and in accordance with Rule 3-10 of Regulation S-X under the Exchange Act, Accredited has been disclosing certain financial information regarding the REIT in the notes to the consolidated financial statements of Accredited contained in Accredited s reports filed under the Exchange Act. In addition, pursuant to the terms of the REIT s outstanding preferred shares and Accredited s related guarantee of those securities, Accredited has also been disclosing certain additional information regarding the REIT in Accredited s Exchange Act reports.

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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. Th include statements containing a projection of revenues, earnings or losses, capital expenditures, dividends, capital structure or other financial terms.

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

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

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

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

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

our ability to qualify as a real estate investment trust for federal income tax purposes and the corresponding tax treatment;

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

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

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

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 Risk Factors located in Management s Discussion and Analysis of Financial Condition and Results of Operations.

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

In this Form 10-Q, unless the context requires otherwise, REIT, we, our, and us means Accredited Mortgage Loan REIT Trust.

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PART I

ITEM 1. Financial Statements

ACCREDITED MORTGAGE LOAN REIT TRUST

BALANCE SHEETS

(Dollars in thousands, except par value)

	June 30, 2006 (Unaudited)	December 31, 2005
ASSETS		
Cash and cash equivalents	$ 5,642	$ 6,158
Restricted cash securitization pre-funding account	352,311	
Accrued interest receivable	38,068	32,604
Mortgage loans held for investment, net of allowance of $121,247 and $98,399, respectively	7,106,478	6,240,136
Derivative assets, including margin account	93,282	65,347
Prepaid expenses and other assets	59,685	30,322
Receivable from parent	171,622	99,642
Total assets	$ 7,827,088	$ 6,474,209
LIABILITIES AND STOCKHOLDERS EQUITY		
LIABILITIES:		
Credit facilities	$ 18,392	$ 15,640
Securitization bond financing	7,419,296	6,169,886
Accrued interest payable	9,314	5,115
Total liabilities	7,447,002	6,190,641
STOCKHOLDERS EQUITY:		
Preferred stock, $1.00 par value; authorized 20,000,000 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 2006 and December 31,2005	4,094	4,094
Common stock, $.001 par value; authorized 100,000,000 shares; issued and outstanding 100,000 at June 30, 2006 and December 31, 2005	1	1
Additional paid-in capital	303,173	303,180
Accumulated other comprehensive income	57,074	23,991
Retained earnings (deficit)	15,744	(47,698)
Total stockholders equity	380,086	283,568
Total liabilities and stockholders equity	$ 7,827,088	$ 6,474,209

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

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ACCREDITED MORTGAGE LOAN REIT TRUST

STATEMENTS OF OPERATIONS

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

	Three Months Ended June 30, 2006	Three Months Ended June 30, 2005	Six Months Ended June 30, 2006	Six Months Ended June 30, 2005
REVENUES:				
Interest income (including $2,459, $224, $4,047 and $431 from parent)	$ 134,905	$ 95,490	$ 260,625	$ 179,587
Interest expense	(81,074)	(44,601)	(152,550)	(79,127)
Net interest income	53,831	50,889	108,075	100,460
Provision for losses on loans held for investment	(6,680)	(7,244)	(13,051)	(10,046)
Net interest income after provision	47,151	43,645	95,024	90,414
Other income	1,150	265	1,838	357
Total net revenues	48,301	43,910	96,862	90,771
OPERATING EXPENSES:				
Management fee assessed by parent	8,321	6,151	16,122	11,497
Direct general and administrative expenses	1	2	9	61
Total operating expenses	8,322	6,153	16,131	11,558
Net income	39,979	37,757	80,731	79,213
Dividends on preferred stock	(2,495)	(2,494)	(4,989)	(4,989)
Net income available to common stockholders	$ 37,484	$ 35,263	$ 75,742	$ 74,224
Basic and diluted earnings per common share	$ 374.84	$ 352.63	$ 757.42	$ 742.24
Weighted average shares outstanding for basic and diluted	100	100	100	100

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

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ACCREDITED MORTGAGE LOAN REIT TRUST

STATEMENTS OF CASH FLOWS

(In thousands) (Unaudited)

	Six Months Ended June 30, 2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 80,731	$ 79,213
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of net deferred origination fees on securitized loans	(2,376)	(1,713)
Amortization of deferred costs	6,626	522
Provision for losses on loans held for investment	13,051	10,046
Unrealized loss (gain) on derivatives and hedged assets	13,213	(3,872)
Adjustment into earnings for gain on derivatives from other comprehensive income	(15,705)	(6,152)
Changes in operating assets and liabilities:		
Accrued interest receivable	(5,464)	3,398
Derivative assets, including margin account	5,664	40,488
Prepaid expenses and other assets	(7,074)	(45,972)
Accrued interest payable	4,200	(557)
Net cash (used in) provided by operating activities	92,865	75,401
CASH FLOWS FROM INVESTING ACTIVITIES:		
Principal payments received on mortgage loans held for investment	1,113,821	807,936
Net cash provided by investing activities	1,113,821	807,936
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of securitization bond financing, net of fees and cash withheld as collateral	2,029,648	1,895,673
Payments on securitization bond financing	(1,145,953)	(812,055)
Net change in credit facilities	(2,010,016)	(1,921,281)
Capital contributions from parent	8,388	3,000
Net increase in receivable from parent	(71,980)	(752)
Payments of common stock dividends	(12,300)	(5,000)
Payments of preferred stock dividends	(4,989)	(4,989)
Net cash used in financing activities	(1,207,202)	(845,404)
Net (decrease) increase in cash and cash equivalents	(516)	37,933
Beginning balance cash and cash equivalents	6,158	4,018
Ending balance cash and cash equivalents	$ 5,642	$ 41,951

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

ACCREDITED MORTGAGE LOAN REIT TRUST

NOTES TO UNAUDITED FINANCIAL STATEMENTS

For the Three and Six Months Ended June 30, 2006 and 2005

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 unaudited financial statements of the REIT have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring accruals, considered necessary for a fair presentation have been included. Operating results for the three and six months ended June 30, 2006 are not necessarily indicative of the results that may be expected for the year ending December 31, 2006. The unaudited financial statements presented herein should be read in conjunction with the audited financial statements and related notes thereto included in the REIT s Annual Report on Form 10-K for the year ended December 31, 2005.

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 operations or financial condition may not be indicative as 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

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

Cash and Cash Equivalents

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

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ACCREDITED MORTGAGE LOAN REIT TRUST

NOTES TO UNAUDITED FINANCIAL STATEMENTS (Continued)

For the Three and Six Months Ended June 30, 2006 and 2005

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

Typically each quarter, the Loans Held for Securitization, which are originated by and to this point have been held in AHL, are contributed at the current 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 loan losses. The loans remain in the Loans Held for Securitization for approximately 10 business days prior to the close of the securitization transaction and are thereafter designated as Loans Held for Investment.

In 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 will be delivered in July and August. In connection with the transaction approximately $350 million of proceeds from the sale of the bonds were withheld an deposited in an interest bearing account (pre funding account) until the remaining collateral is delivered. In July, $173.3 million additional collateral in the form of mortgage loans was delivered. During the three-month period ended June 30, 2005 Accredited completed one securitization of mortgage loans totaling $0.9 billion.

The securitization is structured legally as a sale, but for accounting purposes is treated as a financing under SFAS No. 140. The securitization does not meet the qualifying special purpose entity criteria under SFAS No. 140 and related interpretations because after the loans are securitized, the securitization trust 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 loans securitized through the securitization trusts that become troubled. Accordingly, the loans remain on the balance sheet as loans held for investment , retained interests are not created for accounting purposes, and securitization bond financing replaces the warehouse debt originally associated with the loans held for investment. The REIT records interest income on loans held for investment and interest expense on the bonds issued in the securitization over the life of the securitization. Deferred debt issuance costs and discounts related to the bonds are amortized on a level yield basis over the estimated life of the bonds.

The REIT periodically evaluates the need for or the adequacy of the allowance for loan losses on its mortgage loans held for investment. Provision for loan losses on mortgage loans held for investment 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 loan as non-accruing at the time the loan becomes 90 days or more delinquent under its payment terms. Probable losses are determined based on segmenting the portfolio relating to their contractual delinquency status and applying the REIT s and AHL s historical loss experience. The REIT also uses other analytical tools to determine the reasonableness of the allowance for loan losses. Loss estimates are reviewed periodically and adjustments 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. Loans foreclosed upon or deemed uncollectible are carried at estimated net realizable value.

Derivative Financial Instruments

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

Fair Value Hedges

As part of the contribution by AHL of loans held for securitization, the REIT acquires certain fair value hedge derivative financial instruments. The REIT continues fair value hedge accounting on these mortgage loans up to several days prior to the close of the securitization. At this time, the fair value hedge instruments are lifted and the hedge positions are capitalized. These capitalized hedge marks are then amortized to interest income, utilizing an effective yield method, over the life of the securitization transaction.

Cash Flow Hedges

Pursuant to SFAS No. 133, hedge instruments have been designated as hedging the exposure to variability of cash flows from our securitization debt attributable to interest rate risk. Cash flow hedge accounting requires that the effective portion of

ACCREDITED MORTGAGE LOAN REIT TRUST

NOTES TO UNAUDITED FINANCIAL STATEMENTS (Continued)

For the Three and Six Months Ended June 30, 2006 and 2005

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

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

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 mortgage loans held for investment. For loans that are 90 days or more delinquent, Accredited reverses income previously recognized but not collected, and ceases to accrue income until all past-due amounts are collected.

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 loans generally results when property collateralizing a loan is foreclosed upon or otherwise acquired by AHL, as our servicer, in satisfaction of the loan. Real estate acquired through foreclosure is carried at fair value less estimated 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 recognized through a charge to earnings. Legal fees and other direct costs incurred after foreclosure are expensed as incurred. At June 30, 2006 and December 31, 2005, real estate owned amounting to $30.2 million and $10.5 million, respectively, net of valuation allowances, is included in prepaid expenses and other assets.

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