ACCREDITED HOME LENDERS HOLDING CO
Form 10-K/A
November 07, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K/A

Amendment No. 1

(Mark One)

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 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 001-32275

ACCREDITED HOME LENDERS HOLDING CO.

(Exact name of registrant as specified in its charter)

Delaware	**04-3669482**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

15253 Avenue of Science

San Diego, California 92128

(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

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ or No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ or No x

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 x

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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 x 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 x

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant as of June 30, 2007 was $343,447,677.

The number of outstanding shares of the registrant s common stock as of July 26, 2007 was 25,124,190.

INCORPORATION BY REFERENCE

Financial statements required to be included in Item 8 contained in Part II of this Annual Report on Form 10-K/A are incorporated by reference therein from ITEM 8 of the Annual Report on Form 10-K for the year ended December 31, 2006 filed by Accredited Mortgage Loan REIT Trust filed with the Securities and Exchange Commission on August 1, 2007 (File No. 333-109964-02).

EXPLANATORY NOTE

This Amendment No. 1 to the Annual Report on Form 10-K of Accredited Home Lenders Holding Co. for the fiscal year ended December 31, 2006 (the Form 10-K) filed on August 1, 2007. is being filed to update certain sections of the Form 10-K including Part I, Item 1. Business, Part I, Item 3. Legal Proceedings, Part II, Item 8. Financial Statements and Supplementary Data and Part IV, Item 15, Exhibits, Financial Statements Schedules and reports on Form 10-K.

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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, Inzura^{SM}, Inzura^{SM} and logo, Common Sense for Uncommon Loans, AAMES INVESTMENT®,INFORMEDBROKER®, LendingBridge^{SM} 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 Résidentels 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. Th include statements containing expectations regarding the integration of Aames Investment Corporation and other internal matters, external development and projections of revenues, earnings or losses, capital expenditures, dividends, capital structure or other financial terms.

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

- our ability to operate at a profit, or sustain consecutive periods of net losses, due to adverse market conditions and other factors beyond our control;
- whether or not our pending merger with an affiliate of Lone Star Fund V (U.S.), L.P. is consummated;
- our ability to realize cost savings, synergies and economies of scale from our acquisition of Aames Investment Corporation and our ability to improve profitability of the combined operations;
- repurchase rates on the mortgage loans that we sell or securitize, which may reduce our cash available for operations and liquidity;
- acceleration of debt repayment obligations due to a failure to meet the covenants contained in our credit facilities, including covenants on minimum profitability, interest coverage, liquidity, and net worth requirements as well as limitations on total indebtedness;
- the degree and nature of our competition, including without limitation their impact on the rates that we are able to charge our borrowers;
- changes in demand for, or value of, mortgage loans due to the attributes, mix and performance of the mortgage loans we originate; the characteristics of our borrowers; and fluctuations in the real estate market, the interest rates or the market in which we sell or 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 7. 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-K, unless the context requires otherwise, Accredited, Company, we, our, and us means Accredited Home Lenders Holding Co. and its subsidiaries.

PART I

ITEM 1. Business

General Development of Our Business

Accredited is a mortgage company operating throughout the United States and in Canada. We originate, finance, securitize, service, and sell non-prime mortgage loans secured by residential real estate. Founded in 1990, our company is headquartered in San Diego, California.

On June 4, 2007, we entered into an Agreement and Plan of Merger (the Merger Agreement) with LSF5 Accredited Investments, LLC, a Delaware limited liability company (Parent), and LSF5 Accredited Merger Co., Inc., a Delaware corporation and wholly owned subsidiary of Parent (Purchaser). The Agreement was amended on June 15, 2007.

Pursuant to the Merger Agreement, and upon the terms and subject to the conditions thereof, Purchaser commenced a tender offer (the Offer) to acquire all of our outstanding shares of common stock, par value $0.001 per share, of Accredited at a purchase price of $15.10 per share, net to the holder thereof in cash (the Offer Price). Pursuant to the Merger Agreement, as soon as practicable after the consummation of the Offer and subject to the satisfaction or waiver of certain conditions set forth in the Merger Agreement, Purchaser will merge with and into Accredited (the Merger) and we will become a wholly owned subsidiary of Parent. In the Merger, the shares of Accredited remaining outstanding following the consummation of the Offer, other than shares held by Parent, Purchaser or by stockholders who have validly exercised their appraisal rights under Delaware law, will be converted into the right to receive the Offer Price.

The obligation of Purchaser to accept for payment and pay for the shares tendered in the Offer is subject to the satisfaction or waiver of a number of closing conditions set forth in the Merger Agreement. It is also a condition to Purchaser s obligation to accept for payment and pay for the shares tendered in the Offer that more than 50% of our outstanding shares of common stock shall have been validly tendered in accordance with the terms of the Offer and not properly withdrawn (the Minimum Condition). The Minimum Condition may not be waived by Purchaser without our prior written consent.

The closing of the Merger is subject to customary closing conditions, and, depending on the number of shares held by Parent and Purchaser after Purchaser s acceptance of the shares properly tendered in connection with the Offer, approval of the Merger by holders of our outstanding shares of common stock remaining after the completion of the Offer. Accordingly, there can be no assurance that the Merger will be consummated. (See Risk Factors Risks Related to the Proposed Merger.)

The Merger Agreement includes customary representations, warranties and covenants by us, Parent and Purchaser, made to each other as of specific dates. We have agreed to operate our business in the ordinary course until the Merger is consummated. We have also agreed not to solicit or initiate discussions with third parties regarding other proposals to acquire us and to certain restrictions on our ability to respond to any such proposal. The Merger Agreement also includes customary termination provisions for both us and Parent. Depending on the circumstances of a termination of the Merger Agreement, we or Parent may be required to pay a termination fee.

The assertions embodied in the Merger Agreement s representations and warranties were made solely for purposes of the contract among us, Parent and Purchaser and may be subject to important qualifications and limitations agreed to by us, Parent and Purchaser in connection with the negotiated terms. Moreover, some of those representations and warranties may not be accurate or complete as of any specified date, may be subject to a contractual standard of materiality different from those generally applicable to stockholders or may have been used for purposes of allocating risk among us, Parent and Purchaser rather than establishing matters as facts.

A copy of the Merger Agreement is attached as Exhibit 2.1 to our Current Report on Form 8-K filed on June 4, 2007. The foregoing description of the Merger Agreement does not purport to be complete and is qualified in its entirety by reference to the Merger Agreement.

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

On September 29, 2006, we acquired the common stock of AaRCS, LLC (AaRCS) an indirect wholly owned subsidiary of Aames. AaRCS, a vendor management services company, was merged with and now operates as our vendor management subsidiary, Vendor Management Services, LLC dba Inzura Settlement Services.

On June 23, 2006, we purchased the wholesale business of Aames for cash. We completed this purchase prior to closing our merger with Aames in an effort to reduce attrition of Aames employees and maximize the potential synergies from the combination of our and Aames s wholesale businesses.

The Aames acquisitions have been accounted for using the purchase method and, accordingly, the consolidated financial statements include the activity of the above companies from their respective dates of acquisition. (See Note 2 in the consolidated financial statements- Business Combinations for additional detail.)

In July of 2004, we formed Accredited Home Lenders Canada, Inc. (AHLC), as a wholly owned Canadian subsidiary, and funded our first Canadian mortgage loan in November that same year. 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 Accredited Mortgage Loan REIT Trust (the REIT), a Maryland real estate investment trust, as a wholly owned subsidiary for the purpose of acquiring, holding and managing real estate mortgages. The REIT 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 certain asset, income and share ownership tests are met. In August 2004, the REIT completed a public offering of 3,400,000 9.75% Series A Perpetual Cumulative Preferred Shares (Series A Preferred Shares), and in September and October 2004 sold an additional 693,678 Series A Preferred Shares pursuant to the exercise of the underwriters over-allotment option and a reopening of the public offering.

Description of Our Business

We are a mortgage company, operating throughout the United States and in Canada, that originates, finances, securitizes, services and sells non-prime mortgage loans secured by residential real estate. We focus 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. We originate mortgage loans primarily based upon the borrowers willingness and ability to repay the mortgage loan and the adequacy of the collateral. Our experienced management team has developed incentive programs, technology tools and business processes that focus our employees on originating non-prime mortgage loans with the financial and other characteristics that should provide a target profit for us.

In 2006, 85% and 15% of our mortgage loan originations were originated through our wholesale and retail channels, respectively. In 2006, our wholesale mortgage loan originations were originated by approximately 12,600 brokers. Prior to funding, each mortgage loan we originate is underwritten by our employees to confirm that the mortgage loan is priced commensurate with its risk as determined in accordance with our underwriting guidelines. We have historically financed mortgage loans through secured warehouse credit facilities or through an asset-backed commercial paper facility. As of July 31, 2007, we are financing mortgage loans through three different secured warehouse credit facilities. As of July 31, 2007, these facilities provided us with approximately $1.7 billion of credit capacity. We typically repay the related borrowings under these credit facilities upon sale or securitization of the mortgage loans. In the current market environment, certain lenders have placed new requirements and restrictions on our ability to fund under the agreements and may continue to add such requirements in the future, further affecting our ability to operate in a normal, uninterrupted manner. As stated in the Item 7. Management s Discussion and Analysis of Financial Conditions and Results of Operations Recent Developments section below, our available credit facility capacity has been and may be substantially reduced in the future.

We typically conduct an analysis to find and select the optimal mortgage loan disposition strategy. We have primarily disposed of our mortgage loans in whole mortgage loan sales and/or securitizations. During 2006, 2005 and 2004, we completed two, four, and four securitizations in the United States, totaling $2.4 billion, $4.2 billion, and $3.3 billion, respectively, all of which were structured as financings for accounting purposes. In January 2007, we completed a securitization totaling $760 million which we also structured as a financing for accounting purposes. For all of the mortgage loans that we have securitized, we have retained the rights to service the mortgage loans.

We have developed incentive programs, technology tools and business processes that reward performance and that we believe result in a balance among the competing factors that are described below. Our incentive programs compensate our employees based upon one or more of these factors. Our technology tools, such as our Revenue Calculator and our profit and loss tools, provide the real-time information that an employee needs to estimate the employee s compensation and simultaneously meet our overall mortgage loan quality and profitability goals. Our business processes incorporate cross-departmental review and feedback that are designed to assist each department in maximizing the quality and profitability of the mortgage loan originated. We have developed our incentive programs, technology tools and business processes over time, and we are constantly reviewing and updating them to meet our evolving needs.

Our Incentive Program

One of our most distinguishing characteristics is that our incentive structure rewards employees throughout our company based upon the criteria that best align each individual s compensation with our overall objectives.

Mortgage loan Origination/Origination Support. Our profit and loss tools promptly allocate to our mortgage loan origination teams both profits from performing mortgage loans as well as prospective losses from problem mortgage loans and recaptured premiums from mortgage loans that paid off early. This allocation affects the personal compensation of our mortgage loan origination staff. In addition, production managers are compensated on their profit and volume achievements. Because the information can be accessed directly by all origination support personnel through our technology tools, they have an immediate understanding of the financial impact of their decisions and therefore are motivated to act in the manner that benefits both themselves and our company.

Underwriting. Bonuses are paid to our underwriting staff based not only upon the number of mortgage loans closed per person, but also generally upon the number of mortgage loans we sell at a profit, that can generally be sold within 120 days. Mortgage loans that do not sell at full or anticipated value or that we are required to repurchase, in certain circumstances count against this measure. Therefore, underwriters are motivated to accurately describe, correctly grade, and approve mortgage loans that can generally be sold within 120 days of origination and that generate profits for our company.

Capital Markets. Our capital markets staff has bonus plans based upon their successful execution of the disposition strategy for the mortgage loans that management has formulated for that month. In addition, they are compensated based upon their ability to sell mortgage loans that fall outside of the normal underwriting guidelines.

Servicing. Our servicing employees have bonus plans based upon achieving assigned delinquency targets and mortgage loan loss rates, which motivate a proactive collections and liquidations approach.

Senior and Executive Management. Senior managers may receive bonuses based upon our achievement of profit and other financial and operational goals set forth in an operating plan at the beginning of each year and approved by our board of directors. Our compensation committee is required to approve individual bonuses for certain senior managers based upon each manager s contribution to the company and to overall profitability.

We believe our incentive programs enhance our performance by aligning each employee s compensation and each job function with our overall profitability objectives.

Our Technology and Management Tools

Our information technology department, in collaboration with our operations department, finance department and business intelligence department, has developed customized versions of commercially available software. Our suite of technology tools enables us to effectively achieve the goals that we have established for our employees individually and for our company as a whole. The principal technology tools that are integral to this effort are:

Revenue Calculator. The Revenue Calculator is our software tool that integrates pricing information from our actual mortgage loan sales with our mortgage loan origination operations. Our retail mortgage loan officer or wholesale account executive inputs information into the Revenue Calculator about the characteristics of the mortgage loan and the borrower, including the interest rate, prepayment penalty, fees, the mortgage loan-to-value ratio (LTV), and the credit score of the borrower. The Revenue Calculator provides each mortgage loan origination team with mortgage loan price information on a real-time basis. Our mortgage loan origination teams can modify various attributes of the mortgage loan they are originating to price for the risk we are taking. Our mortgage loan origination teams can then immediately see how the value of the mortgage loan is increased or decreased from the point of view of the secondary market and likewise how their compensation for that mortgage loan will be increased or decreased. Each member of our origination team is focused on pricing for the risk we take and producing profitable mortgage loans. To maintain the accuracy of our Revenue Calculator, we update this mortgage loan pricing model at least monthly, and sometimes more often, based upon actual mortgage loan sales and input from mortgage loan purchasers.

Profit and Loss Tools. We have additional tools that measure the profitability of various operating units. The Profit Center Report system (PCR) provides comprehensive revenue and expense information for each operating unit, including a full allocation of corporate expenses. The Problem Loan Report system (PLR) generates reports that allocate losses on mortgage loans back to the team that originated such mortgage loans. These reports also show the profit and loss of every other team in that team s division, the total division, every other division in our company and our company as a whole, allowing each unit to compare its performance to that of the other units. Each team s operations and sales managers are also compensated on their team s profitability and have a strong incentive and the necessary information to reduce expenses and increase the value of their mortgage loan production.

Origination Systems. We use a combination of vendor provided and in-house applications that we have configured for use in our workflow processes. These data systems combine all the information regarding a mortgage loan, flag any potential underwriting problems, enable documentation and electronic transmittal, facilitate the mortgage loan closing process, and populate our enterprise data warehouse. See Our Underwriting Process and Guidelines.

Our Business Processes Teamwork and Checks and Balances

We have two principal components to our business: we originate and underwrite mortgage loans, and we sell or securitize and service our mortgage loans. We have an integrated approach to these activities that encourages teamwork and the sharing of information across divisions.

Sharing information among our divisions gives each team the information it needs to optimize its performance. For example, our credit committee determines our underwriting guidelines and is composed of the Director of Capital Markets (who is responsible for mortgage loan disposition), the Director of Operations (who is responsible for underwriting and servicing, and maintaining underwriting guidelines), the Director of Credit Risk (who is responsible for underwriting guidelines and business intelligence), and the President and Chief Operating Officer (who is responsible for, among other things, mortgage loan production). Others invited to make contributions to these policies may include the Director of Corporate Underwriting, the Manager of the Inventory Control Unit (which deals with problem mortgage loans), and the Director of Internal Audit and Quality Control. Our secondary marketing committee includes the Director of Operations, the Director of Capital Markets, the Secondary Marketing Manager, and the Executive Vice President, as well as the Chief Financial Officer and Chief Executive Officer, to ensure that balance sheet considerations, secondary market considerations, mortgage loan performance objectives and marketing matters are all taken into account. These committees share information to optimize decisions, but the decisions are still made by functional managers.

Each division manager has access to division and team-level information from all other divisions. In addition to the incentives we provide to each division manager to achieve division-level profit objectives, the sharing of information also motivates each division to maximize its own profit compared to that of other divisions within the framework of our company s overall goals.

We have structured our incentive system to emphasize both the importance of each division individually and also cross-division cooperation. Our account executives and mortgage loan officers are rewarded based upon originating profitable mortgage loans and our underwriting teams are rewarded based upon producing quality mortgage loans. For example, origination team personnel can process and present mortgage loans, but if the mortgage loans do not meet the quality standards of the corporate underwriting teams or the profit objectives of the origination team and division, the mortgage loans may not be approved.

These checks and balances have been built into our origination and underwriting processes and are bolstered by our incentive programs and technology tools. Our mortgage loan officers and account executives work closely with our underwriting group to ensure that mortgage loan applications meet the quality standards necessary to make it through the underwriting and funding process. The first step is a comprehensive underwriting by the origination team supporting our account executives and mortgage loan officers. Then, before the mortgage loan documents can be prepared, the mortgage loan is reviewed and audited by a corporate underwriter who does not report to the origination team. When the team has gathered any required conditions (sometimes called stipulations), mortgage loan documents are reviewed by the documents and funding team or a corporate underwriter before funding. After funding, the mortgage loan documents are reviewed by our documents and funding teams again to ensure accuracy, to make corrections to the documents if necessary and to reflect any changes that may have been made by the closing agent.

We use our Revenue Calculator at various stages to determine the potential value of the mortgage loan, particularly if any of the mortgage loan s attributes have changed. While the Revenue Calculator assigns a prospective value for a mortgage loan, the mortgage loan is still underwritten by each team and reviewed by one of our corporate underwriters to assure that the information in the Revenue Calculator is accurate and represents a correct value assessment of the mortgage loan.

Accordingly, the interest rate and maximum mortgage loan amount are determined based upon our underwriting and quality standards, risk assessment, the benefit to the borrower, and our Revenue Calculator s prediction of the value of each mortgage loan. Our profit and loss tools promptly allocate both profits from performing mortgage loans as well as prospective losses from problem mortgage loans to the team that originated them. This allocation affects the personal compensation of our mortgage loan origination staff.

We believe that our commitment to originating quality mortgage loans strengthens our relationships with warehouse line providers, whole mortgage loan purchasers, rating agencies and others with whom we do business.

Mortgage Loan Origination

We have been originating non-prime mortgage loans since 1990 and have been funding such mortgage loans since 1993. In 2006, we originated $15.8 billion in mortgage loans in the United States and Canada. In 2006**,** 85% and 15% of our mortgage loan originations were originated through our wholesale and retail channels, respectively. In 2006, our wholesale mortgage loan originations were originated through approximately 12,600 brokers. These independent brokers throughout the United States and Canada work with 540 (as of December 31, 2006) account executives in our wholesale divisions. In both 2006 and 2005, our top ten brokers represented in the aggregate approximately 6% of our total mortgage loan origination volume. Our retail channel generates leads primarily through telemarketing, direct mail and the Internet, and as of December 31, 2006, originated mortgages through approximately 1,100 mortgage loan officers working in over 100 retail branches.

The following table summarizes information regarding our total mortgage loan originations during the years ended December 31:

	2006	**2005**	**2004**
Aggregate Mortgage Loan Production(1)			
Total originations (in thousands of dollars)	$ 15,766,823	$ 16,582,640	$ 12,422,190
Average principal balance per mortgage loan	181,779	153,120	136,997
Combined weighted average initial LTV	87.8%	90.2%	90.6%
Net cost to originate(2)	1.6%	1.6%	1.9%
Aggregate Mortgage Loan Production by Borrower Purpose			
Cash-out refinance, including debt consolidation	61.1%	51.2%	51.2%
Purchase	36.6%	47.0%	45.3%
Rate and/or term refinance	2.3%	1.8%	3.5%
Wholesale Mortgage Loan Production(3)			
Total originations (in thousands of dollars)	$ 13,396,431	$ 14,947,003	$ 11,217,528
Percentage of total originations	85%	90.1%	90.3%
Average principal balance per wholesale mortgage loan	186,895	155,917	139,577
Average volume production per account executive (in thousands of dollars)	22,054	30,808	26,666
Combined weighted average initial LTV	88.9%	91.1%	91.4%
Retail and Other Mortgage Loan Production			
Total originations (in thousands of dollars)(1)	$ 2,370,392	$ 1,635,637	$ 1,204,662
Percentage of total originations	15%	9.9%	9.7%
Average principal balance per retail mortgage loan	157,427	131,548	116,878
Average volume production per mortgage loan officer (in thousands of dollars)	2,171	4,246	3,650
Combined weighted average initial LTV	81.3%	82.7%	83.4%

(1) Includes $493.1 million in mortgage loans originated by former Aames retail branches in the fourth quarter.

(2) Net cost to originate mortgage loans is defined as total operating expenses, less mortgage loan servicing related costs, plus yield spread premiums, less points and fees collected, all prior to any deferrals of origination costs for accounting purposes.

(3) Represents wholesale originations.

Wholesale Channel

Our wholesale channel originates non-prime mortgage loans through relationships with businesses that broker mortgage loans, including small mortgage bankers, local banks and businesses that only broker mortgage loans. We offer a variety of mortgage products to help these brokers provide better service to their borrowers. These brokers rely upon our account executives and our regional processing teams whom we believe provide consistently superior customer service.

The mortgage brokers we work with identify borrowers and help them complete mortgage loan applications and obtain necessary documentation. They act as our liaison with the borrower during the lending process. Our regional processing teams underwrite each application and determine the interest rate and other mortgage loan terms for acceptable applications. The regional processing team, following corporate underwriting approval, funds the mortgage loan with the help of one of our divisional documents and funding teams upon acceptance by the borrower and satisfaction of all conditions to the mortgage loan. By relying upon brokers to market our products and to assist borrowers throughout the mortgage loan application process, we can increase mortgage loan volume through the wholesale channel without increasing marketing, labor and other overhead costs associated with attracting new borrowers to the same extent as those we incur in connection with our retail mortgage loan production.

While account executives are the main sources for new brokers, new brokers also enter our wholesale network from other sources. A broker must provide business references, a current copy of each license under which the broker operates, a W-9 form and an executed mortgage originator agreement. Our broker administration unit screens brokers, prevents mortgage loans from proceeding in our mortgage loan origination systems for brokers whose licenses have expired, and prevents mortgage loans from funding if the broker has been disapproved.

Mortgage brokers receive compensation in the form of points and fees paid by borrowers, yield spread premium paid by the lender, or a combination of these items. The mortgage loan programs we offer brokers are comparable to those offered by our competitors; however, we believe we compete for brokers primarily based upon the quality of the service we provide, particularly those with whom we cultivate key account relationships. We commit to turn-around times, we offer coherent, presentable approvals, personal contact and a comprehensive menu of products for our customers, and we endeavor to make it easier to do business with us than with our competitors. In exchange, we minimize yield spread premium to mortgage brokers, we avoid unwarranted credit exceptions, and we charge for the risk we take. We believe that our focus on quality service and reliability may enable us to increase our market share.

We believe that one of the keys to our success is exceeding the expectations of our customers, whom we view as both brokers and borrowers for our wholesale operations. Accordingly, we are focused on improving our responsiveness to our customers. We intend to continue to:

- add high-quality account executives to service wholesale brokers and their customers throughout our nationwide network;
- provide specialized service levels to our top brokers, whom we call our key accounts, for each account executive;
- focus on using technology and improving our processes to make our mortgage loan origination process more efficient; and
- invest in the training and development of sales and operations personnel.

Our continued efforts to increase the profitability of our wholesale channel will center on the following initiatives. We will:

- maintain policies and procedures designed to originate mortgage loans that adequately compensate us for the risk we take;
- reduce our general and administrative costs by re-engineering our work flow process and improving our use of technology; and
- improve the productivity of our account executives.

Retail Channel

Historically, a lesser percentage of our mortgage loan originations have been originated through our retail channel, Home Funds Direct. Home Funds Direct originates mortgage loans through two different retail organizational structures: branch and centralized.

Our branch retail division originates non-prime mortgage loans through our branch locations throughout the United States. Our branch retail mortgage loan officers interact with borrowers in our branch locations, primarily through telemarketing, direct mail and Internet solicitations. Our branch retail mortgage loan officers are also encouraged to develop personal mortgage loan referral sources. The proximity of the branch offices to certain of our prospective borrowers may be helpful in closing the mortgage loans. As part of our efforts to manage the credit risk of mortgage loans originated in our branch retail offices, all mortgage loan underwriting, closing, funding and shipping are done centrally out of one divisional processing center located in Irvine, California. A typical branch retail office consists of approximately seven employees, including a branch manager, five loan officers and one loan processor.

We also originate loans through larger centralized retail offices, which, as of December 31, 2006, were located in Arizona, California, Texas, Georgia, and Kansas (this office was closed in March 2007). Our centralized retail division operates with little expectation that there will be face-to-face contact with the borrower. The marketing concept is for mortgage loan officers in our centralized retail branches to use telemarketing and direct mail to reach prospective borrowers in target markets. These locations have a larger group of experienced personnel, and have the ability to fully process and underwrite mortgage loans, subject to our corporate underwriting oversight policies.

Our Underwriting Process and Guidelines

Each mortgage loan that we originate is underwritten prior to mortgage loan closing in accordance with our underwriting guidelines. We have developed underwriting processes and criteria that we believe generate quality non-prime mortgage loans. Our underwriting guidelines are designed to help us evaluate a borrower s credit history, his or her capacity, willingness and ability to repay the mortgage loan, and the value and adequacy of the collateral. In addition, we review credit scores derived from the application of one or more nationally recognized credit-scoring models. Our underwriting philosophy is to analyze the overall situation of the borrower and to take into account compensating factors that may be used to offset certain areas of weakness, including employment stability, number of years at residence and disposable income. Based upon this analysis and the information derived from the Revenue Calculator, we determine mortgage loan terms and conditions to produce mortgage loans that we believe are appropriately priced and sized, meet our quality standards, and are profitable. In addition, our underwriters must determine what we believe to be a benefit to the borrower for each mortgage loan they underwrite. Our underwriting process and guidelines require a rigorous application review and documentation designed to maximize the value of our mortgage loans.

Our Underwriting Personnel. All of our mortgage loan underwriting is performed by our underwriting personnel, and we do not delegate underwriting authority to any broker or third party. Each mortgage loan origination team underwrites our mortgage loans subject to the final approval of our corporate underwriters. In addition to the daily supervision of all underwriting decisions, these corporate underwriters conduct regular training sessions on emerging trends in production, as well as provide feedback to the mortgage loan origination teams from the monthly problem mortgage loan reports. Each corporate underwriting manager reports, not through the mortgage loan origination organization, but to the Director of Underwriting, who in turn reports to the Director of Operations. Our corporate underwriters generally have a minimum of ten years of industry experience, and many have been with us for more than five years. Our Directors of Underwriting and Operations each have over 20 years of industry experience.

Our Underwriting Guidelines. Our underwriting guidelines are established by our credit committee, which is composed of the Director of Capital Markets, the Director of Operations and the President and Chief Operating Officer. Others invited to make contributions to these policies include the Director of Underwriting, the Director of Credit Risk, the Manager of the Inventory Control Unit, and the Director of Internal Audit and Quality Control. To the extent that an individual mortgage loan application does not meet our published underwriting guidelines, our mortgage loan origination teams and underwriters can make underwriting exceptions. Any losses on mortgage loans are allocated back to the origination team by our profit and loss accountability system. Mortgage loan exceptions are tracked in our data warehouse and the performance of mortgage loans with and without exceptions is monitored. We may, from time to time, apply underwriting criteria that are either more stringent or more flexible depending upon the economic conditions of a particular geographic market. We may, and have, also added non-traditional mortgage products such as mortgage loans with a 40 year amortization schedule.

Mortgage Loan Applications and Credit Reports. Each prospective borrower completes a mortgage loan application that includes information with respect to the applicant s liabilities, income, credit history, employment history and personal information. At least one credit report on each applicant from an independent, nationally recognized credit reporting company is required. The credit report typically contains information relating to such matters as credit history with local and national merchants and lenders, installment debt payments and any record of defaults, bankruptcies, repossessions, or judgments.

Property Appraisals. A full appraisal of the property proposed to be pledged as collateral for the mortgage loan is generally required in connection with the origination of each first priority mortgage loan and each second priority mortgage loan greater than $50,000. Appraisals are performed by licensed, third-party, fee-based appraisers and include, among other things, an inspection of the exterior and interior of the subject property. Appraisals are also required to address neighborhood conditions, site and zoning status and the condition and value of improvements. Following each appraisal, the appraiser prepares a report, which includes a reproduction costs analysis, when appropriate, based upon the current cost of constructing a similar home and market value analysis based upon recent sales of comparable homes in the area. Appraisals generally conform to the Uniform Standards of Professional Appraisal Practice and must be on forms acceptable to Freddie Mac and Fannie Mae. Before the mortgage loan is funded, every appraisal is reviewed by our appraisal review department, one of our qualified underwriters, or by a non-affiliated appraisal review firm. The appraisal may not be more than 180 days old on the day the mortgage loan is funded. A second full appraisal is required for combined mortgage loan amounts and/or property values greater than $1,000,000. For second priority mortgage loans of $50,000 or less, drive-by appraisals alone are acceptable. The standard appraisal may be waived in favor of an Insured Automated Value Model (AVM) with a physical inspection, provided the mortgage loan meets certain criteria. The Insured AVM is effective for the life of the mortgage loan, is transferable, and provides an unbiased opinion of the property value. The Insured AVM process includes a Property Condition Report which is a drive-by inspection that verifies the collateral is conforming. The insurance certificate provides protection that minimizes loss severity in the event of foreclosure.

Income and Asset Verification. Our underwriting guidelines require verification or evaluation of the income of each applicant pursuant to our Full Documentation, Lite Documentation or Stated Income programs. Under each of these programs, we review the mortgage loan applicant s source of income, calculate the amount of income from sources indicated on the mortgage loan application or similar documentation, and calculate debt service-to-income ratios to determine the applicant s ability to repay the mortgage loan. Under the Full Documentation program, applicants are generally required to submit the most current year-to-date pay stubs and written verification of income signed by the employer, Forms W-2 or 1040 and, in the case of self-employed applicants, the most recent two years completed tax returns, signed year-to-date profit and loss statement, or bank statements, in each case covering the preceding two years. Personal bank statements are acceptable as Full Documentation, with the preceding 24 months as Alt2 documentation type or the preceding 12 months as Alt1. Under the Lite Documentation program, applicants must be self-employed and are required to submit personal bank statements covering the preceding six months. Under the Stated Income program, applicants are evaluated based upon income as stated in the mortgage loan application. Under all programs, we may verify by telephone employment, business and income, and self-employed applicants may be required to submit a business license.

Verification of the source of funds, if any, required to be paid by the applicant at closing is generally required under all documentation programs in the form of a standard verification of deposit, two months consecutive bank statements or other acceptable documentation. Twelve months mortgage payment or rental history must be verified by the related lender or landlord on required programs.

Credit Classifications. A critical function of our underwriting process is to identify the level of credit risk associated with each applicant for a mortgage loan. We have established five principal classifications, ranging from A+ to C, with respect to the credit profile of potential borrowers, and we assign a rating to each mortgage loan based upon these classifications. We have a sixth, generally inactive credit classification, called C- , which may be for a borrower with a current or recent foreclosure or bankruptcy. This sixth credit classification or C- can be used on an exception basis with approval from executive management, and in 2006, 2005 and 2004, represented 0.3%, 0.3% and 0.2%, respectively, of our mortgage loans originated. We assign credit grades by analyzing mortgage payment history, consumer credit history, credit score, bankruptcy history, and debt-to-income ratio. Our standard for assigning credit grades are stricter for Lite Documentation and Stated Income programs than for Full Documentation programs, and we discourage credit grades below B for Lite Documentation and Stated Income programs.

Underwriting Tools. We have tools that help each mortgage loan origination team underwrite, document, and track each mortgage loan. These tools integrate the line item detail of the credit reports we receive from the credit reporting agencies, our own analysis of an applicant s income, and a comprehensive review of the total credit profile of the borrower and any exceptions made to our credit policies. The product of these tools, in addition to the information they contribute to our database, is a four-page review of each mortgage loan that is placed at the beginning of each mortgage loan file. Third-party underwriters and purchasers of our mortgage loans make comprehensive use of these reports in their review of our mortgage loan files. These tools are used by all of the origination teams, as well as by corporate underwriting, our documents and funding teams, our post-closing and shipping departments, and other functional units within our company. The data provided is transferred into our enterprise data warehouse. We use software provided by ProClarity and Informatica to make this information readily available to management.

We have deployed an automated decision system, however, we continue to use our staff to audit credit, income and appraisal documentation to ensure that mortgage loans approved in the automated system are consistent with our underwriting guidelines. Furthermore, we anticipate that many mortgage loans will not align with the matrix compliance features of an automated underwriting system, and such mortgage loans will be reassigned to a more traditional underwriting process. Our intention in adopting this technology is to increase the level of our mortgage loan originations without having to correspondingly increase the number of underwriters.

Internal Audit and Quality Control. We maintain an internal audit and quality control department. The Director of Internal Audit and Quality Control reports to the CEO and the Audit Committee. The internal audit and quality control department conducts operational and financial audits of our business processes and coordinates with applicable business units to test compliance with Section 404 of the Sarbanes Oxley Act of 2002 (SOX).

The internal audit Department evaluates and supports the manner in which management upholds its responsibilities to: (1) safeguard the assets and income of the company, (2) provide for reliable and timely financial statements and reporting of other critical information and (3) maintain compliance with ethical standards, policies, plans and procedures of the company and with applicable laws and regulations. To accomplish these objectives, the internal audit department reviews the system of internal controls and reports control deficiencies to senior management and the Audit Committee. An annual risk assessment is performed to determine the audit schedule, which is submitted for review and approval by the Audit Committee. The audit programs are developed to focus on perceived risks and opportunities for improving business and control processes. Additionally, to ensure compliance with SOX requirements, SOX testing activities are coordinated between the internal audit department, the SOX Compliance Manager, external resources, the Controller, the CFO and the EVP. Deficiencies noted during the review of SOX testing are assessed for immediate remediation and results are reported to our Audit Committee and Disclosure Committee.

Each month, the quality control department reviews and re-underwrites a statistical sampling of all of the mortgage loans that are originated. The initial sample focuses on any mortgage loan with a first payment default or where misrepresentation is suspected. The quality control department re-underwrites these mortgage loans, re-verifies the sources of income, re-verifies employment, and reviews the appraisals to ensure collateral values for the mortgage loans are supported. When material misrepresentation is suspected, the quality control department undertakes a comprehensive re-underwriting of not only that mortgage loan, but other targeted mortgage loans connected by broker, appraiser, or other parties to the transaction. In addition, the quality control department performs specific mortgage loan tests to verify that mortgage loan originations comply with relevant regulatory requirements. The tests focus on verifying proper completion of borrower disclosures and other mortgage loan documentation, correct processing of all legally required documentation, and compliance with timeframes imposed by applicable laws. All findings of the quality control department are reported on a regular basis to members of senior management, including the CEO, COO and Director of Operations, and the Audit Committee of the Board of Directors. Management analyzes the results of the monthly quality control reviews as well as performance trends and servicing issues. Based upon this analysis, corrective actions are taken.

Mortgage Loan Programs. We typically offer a range of non-prime mortgage and (to a lesser degree) Alt-A mortgage loan programs. The key distinguishing features of each program are the documentation required, the LTV, the mortgage and consumer credit payment history, the property type and the credit score necessary to qualify under a particular program. Nevertheless, each program relies upon our analysis of each borrower s ability to repay, the risk that the borrower will not repay us, the fees and rates we charge, the value of the collateral, the benefit we believe we are providing to the borrower, and the mortgage loan amounts relative to the risk we believe we are taking.

In general, our LTV maximums decrease with lower credit quality, and, within each credit classification, our LTV maximums vary depending on the property type. Our LTV maximums for mortgage loans secured by owner-occupied properties are higher than for mortgage loans secured by properties that are not owner-occupied. Our LTV maximums for Lite Documentation and Stated Income Programs are generally lower than the LTV maximums for corresponding Full Documentation programs. Our maximum debt service-to-income ratios range from 50% to 55% for Full Documentation Programs and from 45% to 55% for Lite Documentation and Stated Income Programs.

Certain programs provide higher LTV s and CLTV s to borrowers in higher credit grades. Credit grades may be determined by the same criteria as in our standard programs, but may also be determined only on the basis of mortgage credit or credit score. Certain programs may also be restricted as to property and occupancy types and documentation requirements.

Our mortgage loans in the United States 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, or two, three, five or seven years with adjustments after the initial fixed period and every six months thereafter, sometimes referred to as adjustable-rate mortgage loans or ARMs. Generally, the payments on our 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 our ARMs are calculated to fully repay the mortgage loans in 30 years, with payment amount adjustments following interest rate adjustments. Each of our ARM programs are also offered with a 40-year amortization period with a balloon feature that is due in 30 years. Our 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. We do not currently offer, or expect to offer, an interest-only option in conjunction with the 40 year due in 30 amortization program.

The interest rate adjustment on adjustable-rate mortgage loans is determined by adding a margin to an index rate, subject to certain adjustment limitations. The margin is a percentage established at mortgage loan origination. The index for ARMs is six-month LIBOR, which is determined as of a specified time prior to the interest adjustment date. It is common during the initial fixed-rate period of an ARM to allow the borrower to pay a rate lower than the margin plus the index at mortgage loan origination. Over time, the rate may adjust upward such that, eventually, the interest rate will equal the index plus the entire margin. Such adjustments to the interest rate are generally limited to no more than 1.5% at each adjustment date, and the interest rates may not be adjusted above or below a maximum and minimum amount specified in the mortgage loan documents. The goal is to acclimate the borrower to the repayment obligation, yet be able to achieve the fully indexed interest rate over time.

Our mortgage loans are made for the purpose of enabling our borrowers to purchase homes, refinance existing mortgage loans, consolidate debt and/or obtain cash for whatever purposes the borrowers desire. Our residential mortgage loans are secured by one-to-four unit primary residences, one-unit second homes, or one-to-four unit investment properties. Eligible property types are deemed to include single-family detached homes, semi-detached and attached homes, row or town homes, individual condominiums, individual units in planned-unit developments, manufactured housing, and leasehold estates. These collateral types are consistent with the Freddie Mac Seller-Servicer Guide for describing mortgage eligibility requirements. The mortgaged properties may be owner-occupied, second or vacation homes, or non-owner-occupied investment properties.

A substantial portion of our US mortgage loans include prepayment penalties. In 2006, 2005 and 2004, 72.8%, 75.8%, and 82.9%, respectively, of the mortgage loans we originated contained such penalties. Borrowers who agree to prepayment penalties generally receive lower interest rates and/or lower mortgage loan fees on their mortgage loans. Borrowers always retain the right to refinance their mortgage loans, but may have to pay a charge of up to six-months interest on 80% of the outstanding principal balance or 5% of the outstanding principal balance on the mortgage loan. Additionally, most of our mortgage loans originated in Canada include prepayment penalty provisions.

Mortgage Loans Held for Sale and Mortgage Loans Held for Investment by Product Type. The following table sets forth information about our US mortgage loans by product at December 31:

Product Type	**2006**		**2005**	
	Mortgage Loans Held for Sale	**Mortgage Loans Held for Investment**	**Mortgage Loans Held for Sale**	**Mortgage Loans Held for Investment**
ARM				
2/28	9.2%	34.2%	28.4%	45.8%
3/27	23.0	9.3	2.2	12.0
5/25	4.8	1.2	1.1	0.4
Forty-year (2/38 and 3/37)	29.6	15.3	34.2	7.0
Other	0.2	0.0	0.3	0.1
Subtotal	66.8	60.0	66.2	65.3
FRM				
Fifteen-year	0.8	1.9	0.5	2.0
Thirty-year	21.1	32.8	14.3	30.4
Balloons	11.3	5.4	19.0	2.3
Other	0.0	0.0	0.0	0.0
Subtotal	33.2	40.0	33.8	34.7
Total	100.0%	100.0%	100.0%	100.0%

Product Type by Payment Feature	**2006**		**2005**	
	Mortgage Loans Held for Sale	**Mortgage Loans Held for Investment**	**Mortgage Loans Held for Sale**	**Mortgage Loans Held for Investment**
Standard				
Adjustable	37.1%	44.6%	58.2%	52.5%
Fixed	21.9	34.7	32.9	33.2
Subtotal	59.0	79.3	91.1	85.7
Interest-Only				
Adjustable	29.6	15.3	7.9	12.8
Fixed	11.4	5.4	1.0	1.5
Subtotal	41.0	20.7	8.9	14.3
Total	100.0%	100.0%	100.0%	100.0%

Mortgage Loans Held for Sale and Mortgage Loans Held for Investment by Borrower s Credit Score. The following table sets forth information about our US mortgage loan production based upon borrowers credit scores obtained from one or more of the three principal credit bureaus at December 31:

Credit Score	**2006**		**2005**	
	Mortgage Loans Held for Sale	**Mortgage Loans Held for Investment**	**Mortgage Loans Held for Sale**	**Mortgage Loans Held for Investment**
Greater than 800	0.2%	0.2%	0.2%	0.2%
751 to 800	3.0	3.8	4.3	3.7
701 to 750	8.4	9.6	11.9	9.1
651 to 700	24.1	25.8	28.5	25.5
601 to 650	28.6	31.9	30.4	33.4
551 to 600	22.5	20.4	14.7	20.2
501 to 550	12.2	8.0	9.6	7.5
451 to 500	0.8	0.1	0.3	0.1
Less than 451	0.2	0.2	0.1	0.3
Total	100.0%	100.0%	100.0%	100.0%

Mortgage Loans Held for Sale and Mortgage Loans Held for Investment by Lien Position. The following table sets forth information about our US mortgage loan production based upon lien position at December 31:

Lien Position	**2006**		**2005**	
	Mortgage Loans Held for Sale	**Mortgage Loans Held for Investment**	**Mortgage Loans Held for Sale**	**Mortgage Loans Held for Investment**
Firsts	92.9%	99.0%	85.8%	99.8%
Seconds	7.1	1.0	14.2	0.2
Total	100.0%	100.0%	100.0%	100.0%

Mortgage Loans Held for Sale and Mortgage Loans Held for Investment by Collateral Type. The following table sets forth information about our US mortgage loan production based upon collateral type at December 31:

Type of Collateral	**2006**		**2005**	
	Mortgage Loans Held for Sale	**Mortgage Loans Held for Investment**	**Mortgage Loans Held for Sale**	**Mortgage Loans Held for Investment**
Single-Family Residence-Detached	74.0%	74.6%	68.3%	75.1%
Multi-Unit/2 to 4	7.6	5.2	11.6	4.2
PUD	11.7	12.1	12.3	13.2
Condo	5.6	6.3	7.1	6.6
Other	1.1	1.8	0.7	0.9
Total	100.0%	100.0%	100.0%	100.0%

Mortgage Loan Production by Product Type. The following table sets forth information about our US mortgage loan production based upon product type at the years ended December 31:

Product Type	**2006**	**2005**	**2004**
ARM			
2/28	15.4%	50.3%	46.9%
3/27	20.2	3.1	20.3
5/25	3.1	0.9	
Forty-year (2/38 and 3/37)	28.5	16.9	
Other	1.1	0.1	0.6
Subtotal	68.3	71.3	67.8
FRM			
Fifteen-year	0.6	0.7	1.4
Thirty-year	20.1	15.9	21.5
Balloons	10.1	11.1	8.0
Other	0.9	1.0	1.3
Subtotal	31.7	28.7	32.2
Total	100.0%	100.0%	100.0%

Product Type by Payment Feature	**2006**	**2005**	**2004**
Standard			
Adjustable	56.5%	58.8%	54.8%
Fixed	29.9	27.5	31.0
Subtotal	86.4	86.3	85.8
Interest-Only			
Adjustable	11.8	12.6	13.0
Fixed	1.8	1.1	1.2
Subtotal	13.6	13.7	14.2
Total	100.0%	100.0%	100.0%

Mortgage Loan Production by Borrower s Credit Score. The following table sets forth information about our US mortgage loan production based upon borrowers credit scores obtained from one or more of the three principal credit bureaus during the years ended December 31:

Credit Score	**2006**	**2005**	**2004**
Greater than 800	0.2%	0.2%	0.1%
751 to 800	3.7	4.0	3.3
701 to 750	10.7	11.8	10.5
651 to 700	27.1	27.4	27.7
601 to 650	28.7	30.6	33.9

551 to 600	18.2	16.1	16.3
501 to 550	11.0	9.6	7.9
451 to 500	0.3	0.2	0.1
Less than 451	0.1	0.1	0.2
Total	100.0%	100.0%	100.0%

Mortgage Loan Production by Lien Position. The following table sets forth information about our US mortgage loan production based upon lien position during the years ended December 31:

Lien Position	**2006**	**2005**	**2004**
Firsts	94.6%	90.9%	91.4%
Seconds	5.4	9.1	8.6
Total	100.0%	100.0%	100.0%

Mortgage Loan Production by Collateral Type. The following table sets forth information about our US mortgage loan production based upon collateral type during the years ended December 31:

Type of Collateral	**2006**	**2005**	**2004**
Single-Family Residence-Detached	68.9%	68.4%	70.9%
Multi-Unit/2 to 4	9.4	10.6	7.3
PUD	12.4	11.5	13.2
Condo	6.2	7.0	6.7
Other	3.1	2.5	1.9
Total	100.0%	100.0%	100.0%

Financing for Mortgage Loan Originations

In 2006, Accredited financed mortgage loans through eight different secured warehouse credit facilities and through an asset-backed commercial paper facility (the ABCP). As of July 31, 2007, we are financing our mortgage loans through three secured warehouse facilities with approximately $1.7 billion of credit capacity (See Item 7. Management s Discussion and Analysis of Financial Conditions and Results of Operations Recent Developments). We repay the related borrowings under these credit facilities upon sale or securitization of the mortgage loans. As of December 31, 2006 we had $1.7 billion in U.S. warehouse debt and $97 million in Canadian warehouse debt outstanding. See ITEM 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources. Accredited s interest expense on warehouse financing as a percentage of total interest expense during 2006, 2005 and 2004 was 34.3%, 38.2% and 46.0%, respectively.

Under the ABCP, the funding of mortgage loan originations had historically been 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, maturing in $40 million increments on May 26, 2010 (one-month LIBOR + 1.45%) and August 25, 2011 (one-month LIBOR + 1.30%). The notes were issued by a special purpose bankruptcy remote Delaware statutory trust which we established for the ABCP. The SLNs accrued interest at a commercial paper market rate (5.43% at December 31, 2006).

At December 31, 2006, the outstanding balance under the ABCP facility, including the subordinated notes was $880 million. The ABCP had historically been collateralized by mortgage loans held for sale or securitization and certain restricted cash balances. By May 31, 2007 the Company voluntarily terminated the program and repaid all subordinated notes and SLNs. (See Item 7. Management s Discussion and Analysis of Financial Conditions and Results of Operations Recent Developments).

The amounts available to borrow under the warehouse credit facilities and the ABCP historically were affected by the lender s or credit support provider s valuation of the underlying collateral. The collateral is subject to revaluation at any time, generally subject to commercial reasonableness and good faith. Downward revaluations of the collateral can result in margin calls on one business day s notice, requiring us to repay amounts previously advanced and reducing our available liquidity.

Our credit facilities contain customary covenants including minimum profitability, interest coverage, liquidity, net worth and limitations on total 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 payment which 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 the other facilities. Prior to year end 2006 and year-to-date in 2007, several of the covenant requirements were amended or waived to remain in compliance with all requirements under the credit facilities at year end. We anticipate requiring additional modifications or waivers to these covenants and, while we anticipate that we will be able to have the agreements amended to waive any covenant violations with our lenders, there can be no assurances that such lenders will amend the covenants to permit our contractual compliance. In the event such modifications or waivers are required and Accredited is unable to obtain them during the remainder of 2007 or thereafter, Accredited may trigger an event of default under our credit facilities, which could in turn result in cross defaults under our other facilities. The occurrence of such events would have a material and adverse impact on our ability to fund mortgage loans and continue as a going concern.

Interest Generated by Warehoused Mortgage loans

We generate a portion of our total revenues from the interest we receive on a mortgage loan from the time we originate the mortgage loan until the time we sell or securitize the mortgage loan. This interest income as a percentage of total interest income for 2006, 2005 and 2004 was 33.6%, 35.2% and 43.1%, respectively. This income is partially offset by our borrowing costs under our warehouse credit facilities used to fund our mortgage loans for the same period. Subsequent to year end, the Company sold substantially all its loans held for sale, thereby significantly reducing its interest generated by warehoused mortgage loans in 2007 (See Item 7. Management s Discussion and Analysis of Financial Conditions and Results of Operations Recent Developments.)

Mortgage Loan Disposition Strategy

We generate revenue primarily through the disposition of the mortgage loans we originate. We use a diversified mortgage loan disposition strategy to convert the mortgage loans we originate into revenue for our company. This strategy includes whole mortgage loan sales and securitizations. In 2006, 2005 and 2004, we sold and securitized a total of $16.1 billion $15.7 billion and $11.6 billion, respectively, of mortgage loans including Canada. Of these amounts, 83.0%, 73.0% and 72.0%, respectively, were whole mortgage loan sales and 17.0%, 27.0% and 28.0%, respectively, were securitized in transactions structured as financings for accounting purposes. Mortgage loan sales generated gain on sale revenues of $202.0 million, $313.1 million and $283.6 million, accounting for 46.5%, 55.1% and 60.4%, respectively, of our total net revenues for 2006, 2005 and 2004. We completed no securitization structured as a sale, for accounting purposes, during these periods.

Mortgage Loan Disposition by Purchaser. Highlighting our diversified disposition strategy, the table below shows, for the year ended December 31, 2006 with comparative amounts for the years ended December 31, 2005 and 2004, the primary purchasers of our mortgage loans, the dollar amount of their purchases, and their purchases as a percentage of total mortgage loan sales:

Name	**2006**	**%**	**2005**	**%**	**2004**	**%**
			(dollars in millions)			
HSBC Mortgage Services Inc.	$ 4,002.3	29.9%	$ 2,714.4	23.7%	$ 2,190.1	26.4%
The CIT Group/Consumer Finance, Inc/CIT Bank	1,616.2	12.1	579.7	5.1	421.1	5.1
WM Specialty Mortgage LLC	1,324.7	9.9				
Morgan Stanley Mortgage Capital Inc	1,049.9	7.9	1,133.9	9.9	2,081.3	25.1
JPMorgan Chase Bank, N.A.	963.4	7.2	186.6	1.6	114.6	1.4
Bank of America, National Association	941.4	7.1			435.3	5.3
Merrill Lynch Mortgage Lending, Inc.	919.7	6.9	183.0	1.6	103.3	1.3
Citigroup Global Markets Realty Corp.	631.8	4.7	72.1	0.6		
IXIS Real Estate Capital Inc.	413.2	3.1	98.0	0.9		
DLJ Mortgage Capital, Inc (CSFB)	322.1	2.4	234.2	2.1	472.5	5.7
All others	1,174.4	8.8	6,235.7	54.5	2,464.0	29. 7
Total mortgage loan sales(1)	$ 13,359.1	100.0%	$ 11,437.6	100.0%	$ 8,282.2	100.0%

(1) Does not include $286.4 million in mortgage loans sold during the fourth quarter which were acquired in connection with our acquisition of Aames.

HSBC Mortgage Services Inc. (HSBC) and certain of our other mortgage loan purchasers have revised their purchasing guidelines and the whole mortgage loan purchase premiums that they are willing to pay in response to ongoing adverse market conditions and borrower default rates. In April 2007, HSBC notified the Company, as well as other non-prime mortgage originators, that HSBC will no longer be purchasing non-prime mortgages. Accordingly, we can make no assurances that HSBC specifically, or our other whole mortgage loan purchasers, generally, will continue to purchase our mortgage loans on terms that are acceptable to us.

We evaluate the best disposition strategy for each pool of mortgage loans we originate, considering the market demand for our mortgage loans, our liquidity needs, our long-term profit objectives and our need to maintain strong relationships with our mortgage loan purchasers.

Whole Loan Sales

In a whole loan sale, we sell all right, title and interest in and to a pool of mortgage loans in exchange for cash in an amount equal to the full market value of the mortgage loans. All of our mortgage loan dispositions are made subject to an obligation to repurchase any mortgage loan that materially violates standard mortgage industry representations and warranties that we make in connection with our mortgage loan dispositions. In 2006, 83.0% of our mortgage loan dispositions were through whole mortgage loan sales and net gains from these sales were $202.0 million. To execute our mortgage loan sales strategy, we have typically established key relationships with a diversified group of sophisticated mortgage loan purchasers. We believe that this strategy increases our opportunity to sell during changing market conditions. As a result, the purchasers listed above include Wall Street investment banking firms that securitize, non-Wall Street mortgage banking firms, national and international banks that both hold and securitize mortgage loans, and large financial services companies that both hold and securitize mortgage loans.

Some of our mortgage loans are sold pursuant to forward commitments, under which we agree to sell, and a purchaser agrees to buy, a specified volume of mortgage loans that meet specified characteristics. We also put pools of mortgage loans out to bid, using our knowledge of our various purchasers preferences to direct pools with certain characteristics to the purchasers most likely to value those characteristics. Prospective purchasers may submit bids on all or portions of the pools that we show them. We generally select the combination of bids that provides us with the best overall execution results. We continuously monitor the preferences of our purchasers and adjust our origination operations accordingly. Mortgage loan officers and account executives use our Revenue Calculator to monitor the mortgage loan characteristics that various purchasers value. We believe that this not only improves the saleability of our mortgage loans, but also improves the price we receive upon the sale of our mortgage loans because purchasers tend to pay higher prices for mortgage loans that meet their requirements. Our disposition strategy balances our objectives of cultivating our relationships with multiple purchasers while striving to maximize the premiums we receive.

Securitizations

As part of our diversified financing strategy, we have historically accessed the asset-backed securitization market to provide long-term financing for our mortgage loans. In a securitization, we sell or transfer a pool of mortgage loans to a trust and retain a residual interest for the right to receive future cash flow. The trust raises the cash purchase price of the mortgage loan pool by selling asset-backed securities, or notes, representing senior interests in the mortgage loans. The purchasers of these interests receive the principal collected on the mortgage loans plus a fixed or adjustable interest rate as stated in the particular note. The residual interest we retain entitles us to receive the interest income generated on the principal amount of the mortgage loans in the trust minus the interest paid to the purchasers of the mortgage loan interests, servicing, trust and other fees and losses on the mortgage loans, provided that certain overcollateralization requirements are met. Depending upon the structure of the asset-backed securities and the performance of the underlying mortgage loans, excess cash flow may not begin to be distributed to us for 12 months or more. As a result of the overcollateralization and certain other credit enhancement features, the trust is able to issue investment-grade, asset-backed securities.

We anticipate that securitizations will continue to contribute to revenues and cash flows. We also anticipate that our securitization transactions will continue to be legally structured as sales, but for accounting purposes will be structured as financings. Under this approach, the mortgage loans remain on our balance sheet 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 securitization. This portfolio-based accounting closely matches the recognition of income with the actual receipt of cash payments.

During 2006, 2005 and 2004, we completed a total of two, four and four securitizations structured as financings in which debt securities totaling $2.4 billion, $4.2 billion and $3.3 billion, respectively, were issued. In January 2007, we completed a securitization totaling $760 million which we structured as a financing for accounting purposes.

Derivative Policies

See ITEM 7. Management s Discussion and Analysis of Financial Condition and Results of Operations.

General Description of REIT s Assets; Investment Policy

Retained Interests in Securitization

We retain interests in our securitizations which represents ownership of the related securitization trust and the right to receive excess cash flow generated by the trust. This excess cash flow is derived from two sources: excess interest and return of over-collateralization.

Each retained interest is subordinate in right of payment to the related securitization note holders. Each retained interest is in a first loss position, and the related securitization trust does not contain a source of funds to protect us against losses on the related mortgage loans.

Excess Interest

Excess interest, if any, consists of interest collections on the related mortgage loans each month after (i) payment of related administrative fees, reimbursements and expenses, including servicing fees, backup servicing fees, trustee fees and expenses and insurer premium, and reimbursements and indemnification of the trustee and the insurer and (ii) payment of required distributions to holders of the related underlying notes.

Excess interest is generally required, among other things, to be used to distribute principal with respect to the related notes until the related notes reach the required overcollateralization amount (as described below).

Principal

Principal collections on the related mortgage loans will generally be distributed to the securitization note holders in order to maintain the required level of overcollateralization for that securitization trust. To the extent that the overcollateralization amount has been permitted to step down (as described below), principal collections may instead be distributed to the related retained interest until the new required overcollateralization amount has been achieved.

Overcollateralization

Overcollateralization for each securitization is the excess, if any, of the outstanding principal balance of the mortgage loans in the related mortgage pool over the principal balance of the related notes. Overcollateralization in each securitization trust is generally achieved by applying available excess interest in the initial years of operation of the securitization trust to make additional payments of principal on the related notes as necessary to maintain the Overcollateralization amount at its required level. In some transactions, the required over-collateralization amount was fully funded on the securitization s closing date. If the level of overcollateralization applicable to a securitization trust in future periods falls below the applicable required overcollateralization amount, cash flows derived from excess interest thereafter will be applied to pay principal and interest on the related notes (and not be available to make distributions with respect to the related retained interests) unless and until once again the applicable required overcollateralization amount is reached.

The required overcollateralization amount for certain mortgage pools may increase if delinquencies or losses on the related mortgage pool were to exceed certain specified levels. The required overcollateralization amount may decrease based upon the satisfaction of certain tests. No distributions will be made from the proceeds of the related mortgage loans to the related retained interest until the then-applicable required overcollateralization amount has been established and maintained.

Generally, to the extent that the cash flows which would otherwise be paid to a retained interest are being directed to the related notes to achieve or maintain the applicable required overcollateralization amount, the related retained interest will not receive any distribution from the related securitization trust. In addition, because the application of the cash flows to each retained interest are dependent upon the performance of the related mortgage loans, there may be material variations in the amount, if any, of the cash flow distributed on each retained interest from period to period, and there may be extended periods when no cash flow is received with respect to each retained interest. Any such variations in the rate or timing of receipt of distributions on each retained interest may adversely affect our ability to make dividend payments on the Series A Preferred Shares.

As described below under The Mortgage Pools , prepayments of principal and realized losses on the related mortgage loans will reduce the aggregate outstanding principal balance of such mortgage loans and therefore will reduce the aggregate amount of excess interest that could be generated by the mortgage loans. The aggregate amount of excess interest generated by the mortgage loans in a mortgage pool will decrease more significantly as a result of principal payments and realized losses on those mortgage loans with relatively high interest rates. If prepayments or liquidations occur with more frequency on mortgage loans in a mortgage pool having relatively higher interest rates than on mortgage loans in a mortgage pool having relatively lower interest rates, and the foregoing results in any of the related notes having their interest rate limited by any applicable available funds cap rate, then no excess interest will be generated by the portion of the aggregate principal balance of such mortgage loans equal to the principal balance of such class of notes. Reductions of the amount of excess interest generated by the mortgage loans in a mortgage pool will in turn reduce the aggregate amount of distributions on the related retained interests. In addition, the notes may be entitled to recover the amount of interest not paid on such classes because of the application of the applicable available funds cap rate, which may result in a reduction of the amount of excess interest that could be included among the amounts that may remain available for distribution to the holders of the retained interests.

Distributions on the retained interests in respect of principal collections on the mortgage loans are also sensitive to the rate and timing of principal payments and realized losses on the mortgage loans in the related mortgage pool. A rapid rate of principal payments on the mortgage loans in a mortgage pool could have the effect of accelerating distributions in respect of principal collections on the related retained interests, and a slow rate of payment could have the effect of decelerating distributions in respect of principal collections on the related retained interests. Generally, the retained interests will not be entitled to receive any distributions until the required overcollateralization amount has been met. Realized losses on the mortgage loans in the related mortgage pool will have the effect of reducing the over-collateralization, and therefore reducing the amount ultimately payable on the related retained interests.

Mortgage Loan Servicing

Once we originate or purchase a mortgage loan, our servicing department begins the administrative process of servicing the mortgage loan, seeking to ensure that the mortgage loan is repaid in accordance with its terms.

We start this process for every mortgage loan, whether we will service the mortgage loan for a matter of weeks before it is sold servicing-released or for its life in a servicing-retained transaction. Our servicing department is divided into mortgage loan administration, customer service and asset management units. In addition, the investor reporting unit of our finance and accounting department performs the servicing-related functions of reporting on all other servicing activities, and in the case of mortgage loans serviced for others, accounting for and remitting all funds collected through servicing activities.

Administration and Servicing

Our mortgage loan administration unit is responsible for boarding each mortgage loan into our servicing operations and technology systems. For mortgage loans on which the monthly payments include amounts to be escrowed for the future payment of real estate taxes and insurance premiums, our escrow administration unit ensures the proper accounting for such funds and the timely payment of the taxes and premiums. For mortgage loans which do not have tax and insurance escrows, the mortgage loan administration unit ensures that the properties securing the mortgage loans are properly insured at all times and that real estate taxes are paid to avoid foreclosures by taxing authorities. This unit is also responsible for the various administrative tasks involved in the transfer of servicing when mortgage loans are sold servicing-released, including notifying borrowers, insurers and taxing authorities. For mortgage loans with adjustable interest rates, this unit ensures that the adjustments are properly made and timely notification is provided to the related borrowers.

Our payment processing unit is responsible for the physical receipt of and initial accounting for all mortgage loan payments from borrowers. We offer our borrowers to establish automatic payment from their bank accounts, which we arrange at no cost to the borrower. Our customer service unit is responsible for welcome calls and handling all inbound calls and other communications from borrowers. The payoff and re-conveyance unit responds to borrower requests for payoff demands and handles all lien releases.

Collection and Enforcement

Our asset management unit is responsible for all phases of the collection and enforcement of delinquent and defaulted mortgage loans. The inherent risk of delinquency and loss associated with non-prime mortgage loans requires hands-on active communication with our borrowers from origination through liquidation. Borrower contact is initiated through outbound telephone campaigns, monthly billing statements, and direct mail, which are tailored to reflect the borrower s payment habit, the mortgage loan s risk profile and the mortgage loan s status. Our collection approach is designed to educate our borrowers on managing their debts to maximize the likelihood of continued timely performance. We establish clear expectations with our borrowers with respect to maintaining contact and working together to resolve any financial problems that may occur. We consider this early intervention a key element of our servicing strategy.

Our early stage mortgage loan counselors begin calling borrowers whose accounts are past due between the 1st and 15th day depending upon their payment history. Once contact is established, we verify pertinent information and determine the reason for the delay in payment. For borrowers who are able to make their payments, we offer the ability to pay by mail, via our website, by phone or through electronic funds transfer. Pay by phone allows the borrower to remit the funds immediately or at an agreed later time in the month and avoids delays using the U.S. postal service. If a borrower indicates a problem that is not temporary or is of a serious nature, the call is promptly referred to a supervisor who will then evaluate the situation and initiate appropriate loss mitigation actions.

When an account becomes thirty-three days delinquent, the borrower receives a notice of intent to foreclose allowing thirty days, or more if required by applicable state law, to cure the default before the account may be referred for foreclosure. The 30-59 day collection personnel continue active collection campaigns and may offer the borrower relief through a payment plan designed to resolve the delinquency in ninety days or less and up to 6 months with supervisor approval. These collectors are seasoned and trained to effectively identify and resolve problems with borrowers before the past due problems escalate.

Accounts moving to sixty or more days delinquent are transferred to the loss mitigation and foreclosure sub-units simultaneously. Our loss mitigation personnel choose a collection strategy that is designed to minimize the loss on a defaulted mortgage loan. We may procure updated property value information, the borrower s current credit profile, and review foreclosure and real estate marketing timelines to determine the best alternative to foreclosure. Our loss mitigation personnel continue to actively attempt to resolve the delinquency while our foreclosure personnel begin the foreclosure process. Our loss mitigation tools include payment plans, short sales, deeds in lieu of foreclosure, stipulated forbearance plans, deferments, reinstatements and modifications.

Delinquent accounts not resolved through collection and loss mitigation activities are foreclosed in accordance with state and local laws. Foreclosure timelines are managed through a timeline report built into the mortgage loan servicing system. The report schedules key milestones throughout the foreclosure process, enhancing our ability to monitor and manage the process. Properties acquired through foreclosure are transferred to the real estate owned, or REO, sub-unit to manage eviction and marketing of the properties. Once a property is vacant, it is listed with a local real estate agent who develops a marketing strategy designed to maximize the net recovery upon liquidation. Second opinions on the value of the property are obtained to validate recommendations given by the primary listing agent. Property listings and monthly status reports are reviewed monthly to ensure the properties are properly maintained and actively marketed.

Our mortgage loan administration unit also handles hazard and mortgage insurance claims, condemnations and other special servicing needs.

Servicing Department Infrastructure

We service our mortgage loans using Interlinq Loan Servicing software provided by Harland Financial Services. We also have additional software modules for the management of bankruptcy, foreclosure and REO processes. Our technology delivers helpful data regarding the mortgage loan and the borrower to the desktops of our servicing personnel. We also have all of our files electronically imaged so that our servicing personnel have access to mortgage loan documents without having to retrieve a paper file.

Monthly incentive plans are in place for all collections, loss mitigation and REO personnel and are tied directly to performance of the servicing portfolio. Both individual and team goals are used to encourage superior results and cooperation between unit members.

Ongoing training for our servicing personnel is provided regularly and covers major relevant topics within the servicing department. In the collection area, supervisors and managers monitor actual telephone calls by each collector on a monthly basis and follow up with one-on-one training and direction. In addition, scripts tailored to typical borrower circumstances are posted at each workstation to ensure the employee asks the appropriate questions for the type of delinquency situation the borrower is experiencing. Outside legal counsel conducts on-site classes or seminars for the foreclosure and bankruptcy areas on an annual basis. Title company representatives also provide on-site training on title issues from time to time.

All of our servicing functions are administered from our San Diego and Orlando service centers as well as Noida, India through our third party vendor. The Orlando service center was opened in August 2004 and currently performs all servicing functions. We began selected servicing functions in India in February 2006. Hours of operation for our servicing department are staggered to cover the different time zones where our borrowers and collateral properties are located. Evening and weekend hours are used to facilitate contact with borrowers that are otherwise unavailable during regular business hours.

Our Delinquency and Loss Experience

The following table sets forth information about the delinquency and loss experience of the mortgage loans we service, which are primarily mortgage loans we have originated and have been or may be securitized, as of and for each of the years ended December 31.

	2006		2005(2)		2004(2)	
	Amount	Delinquency Percentage(1)	Amount	Delinquency Percentage(1)	Amount	Delinquency Percentage(1)
	(dollars in thousands)					
Total Accredited servicing portfolio	$ 9,675,658(3)		$ 9,706,153(3)		$ 6,731,581(3)	
Delinquencies:						
30-59 days	$ 150,683	1.6%	$ 76,526	0.8%	$ 33,134	0.5%
60-89 days	93,044	1.0%	31,962	0.3%	11,325	0.2%
90 or more days	332,122	3.4%	100,333	1.1%	58,307	0.8%
Subtotal	575,849	6.0%	208,821	2.2%	102,766	1.5%
Real estate owned	118,828	1.2%	28,928	0.3%	14,357	0.2%
Total	$ 694,677	7.2%	$ 237,749	2.5%	$ 117,123	1.7%
Losses on servicing portfolio	$ 51,767	0.5%(1)	$ 22,193	0.3%(1)	$ 17,505	0.3%(1)

	2006	
	Amount	Delinquency Percentage(1)
	(dollars in thousands)	
Total Aames servicing portfolio	$ 1,364,470	
Delinquencies:		
30-59 days	$ 55,951	4.1%
60-89 days	31,009	2.3%
90 or more days	101,677	7.4%
Subtotal	188,637	13.8%
Real estate owned	28,287	2.1%
Total	$ 216,924	15.9%
Losses on servicing portfolio	$ 3,415	1.0%(1)

(1) The percentages are calculated based upon the respective loss amounts on the servicing portfolio for the year ended divided by the average servicing portfolio during the year.

(2) We have changed the presentation from 2005 and 2004 to conform to 2006.

(3) Includes mortgage loans sold with servicing retained of $60.4 million, $90.2 million, and $171.0 for the years ended December 31, 2006, 2005 and 2004, respectively.

We review our delinquency and loss rates when setting loss reserves for mortgage loans. (Item 7. Management s Discussion and Analysis of Financial Conditions and Results of Operations-Provisions for Losses). Increases in actual delinquency and loss rates could affect the loss assumptions used in setting loss reserves. If the loss assumptions used to set loss reserves are increased, it could adversely affect our operating results.

Competition

We face intense competition in the businesses of originating and selling mortgage loans.

Our competitors in mortgage origination include mortgage banking companies, consumer finance companies, diversified financial institutions, commercial banks, credit unions, savings and mortgage loans, credit card issuers and insurance finance companies. Many traditional mortgage lenders also offer products similar to those we offer to our borrowers. Fannie Mae and Freddie Mac are also adapting their programs to include non-conforming products and have begun to expand their operations into the non-prime market. We are experiencing increased competition over the Internet. Many of these competitors, including large financial corporations taking advantage of consolidation opportunities in the industry, are substantially larger and have more capital, or have greater access to capital at lower costs than our cost of capital under our warehouse credit facilities, and may have greater technical and marketing resources than we have. Efficiencies in the asset-backed securities market have generally created a desire for increasingly larger transactions, giving companies with greater volumes of originations a competitive advantage.

Competition in the industry can take many forms, including interest rate and cost of a mortgage loan, convenience in obtaining a mortgage loan, the underwriting requirements for a mortgage loan, customer service, amount and type of mortgage loan, and marketing and distribution channels. Additional competition has and may continue to lower the rates we can charge borrowers relative to our borrowing costs and potentially lower gains from cash-based whole mortgage loan trades and our net interest margin from securitizations. We believe we compete primarily based upon the quality of the service we provide to mortgage brokers, particularly those with whom we cultivate key account relationships. We commit to turn-around times, offer coherent, presentable approvals, personal contact and a comprehensive menu of products for our customers. We endeavor to make it easier to do business with us than with our competitors. In exchange, we minimize yield spread premium to mortgage brokers, avoid unwarranted credit exceptions, and charge for the risk we take. Accordingly, our competitors may offer better financial terms to potential borrowers and we may be unable or unwilling to originate mortgage loans with comparable terms.

We believe that our competitive strengths are:

Bottom-line Based Business Model and Supporting Tools. We have created a culture that provides economic incentives to our employees to assess the risk in our mortgage loans correctly, report the risk accurately, and price the risk so as to assure fairness to the borrower and profits to our company. We believe that our bottom-line based philosophy and technology tools give us a competitive advantage by directly rewarding our employees for contributing to our fundamental business goal of sustained profitability.

Experience. We have over 50 managers and executives with over 20 years of experience in consumer finance and non-prime mortgage lending. Each of our wholesale and retail divisions is run by a seasoned executive who is evaluated and compensated based upon the profitability, including a full allocation of corporate costs and mortgage loan losses, of the executive s division.

Diversification. We have diversified our mortgage loan origination and disposition channels. Our top ten brokers in 2006 represented in the aggregate approximately 6% of our total mortgage loan origination volume. In 2006, we sold to in excess of 20 whole mortgage loan purchasers, and during 2006, 2005 and 2004, we successfully completed a total of ten independent securitizations.

Conservative Management Principles. We focus on originating quality mortgage loans and generating predominately cash earnings rather than non-cash gain on sale earnings.

We believe these strengths enable us to originate better-performing, non-prime mortgage loans, and grow a more profitable, more conservatively managed company than many of our competitors.

Our competitive position may be affected by fluctuations in interest rates and general economic conditions. During periods of rising interest rates, competitors that have locked in low borrowing costs may have a competitive advantage. During periods of declining interest rates, competitors may solicit our borrowers to refinance their mortgage loans. During economic slowdowns or recessions, our borrowers may face new financial difficulties and may be receptive to refinancing offers by our competitors.

Regulation

The mortgage lending industry is highly regulated. Our business is regulated by the federal, state, provincial (Alberta, British Columbia, Manitoba and Ontario) and local government authorities and is subject to federal, state and local laws, rules and regulations, as well as judicial and administrative decisions that impose requirements and restrictions on our business. At the federal level, these laws and regulations include, but are not limited to:

- the Equal Credit Opportunity Act and Regulation B;
- the Federal Truth in Lending Act and Regulation Z;
- the Home Ownership and Equity Protection Act and Regulation Z;
- the Real Estate Settlement Procedures Act and Regulation X;
- the Fair Credit Reporting Act;
- the Fair and Accurate Credit Transactions Act;
- the Home Mortgage Disclosure Act and Regulation C;
- the Fair Housing Act;
- the Sarbanes-Oxley Act;
- the Gramm-Leach-Bliley Act;
- the Servicemembers Relief Act;
- Regulation AB;
- the USA Patriot Act;
- the Federal Trade Commission Act; and

- the Telemarketing and Consumer Fraud and Abuse Prevention Act.

These laws, rules and regulations, among other things:

- impose licensing obligations and financial requirements on us;
- limit the interest rates, finance charges, and other fees that we may charge;
- prohibit discrimination;
- impose underwriting requirements;
- mandate disclosures and notices to consumers;
- prohibit or restrict certain loan product terms and conditions;
- regulate our advertising and marketing practices;
- in some cases, impose assignee liability on the entities that purchase our mortgage loans or on us for mortgage loans we purchase;
- impose corporate governance, internal controls and financial reporting obligations and standards;
- restrict sharing of personal, non-public information and require the establishment of appropriate data security measures;

- regulate our servicing and collection practices;
- require us to prevent money-laundering or the conduct of business with suspected terrorists; and
- prohibit certain patterns of unsolicited phone calls, establish time of day restriction on such calls, and require certain disclosures in sales calls.

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 buyers of our mortgage loans;
- class action and individual lawsuits; and
- administrative enforcement actions.

We actively analyze and monitor the laws, rules and regulations that apply to our business, as well as the changes to such laws, rules and regulations. We seek to maximize the extent to which we can program the laws, rules and regulations into our technology tools, thereby substantially reducing human error as a source of non-compliance. In addition, user-friendly summaries of relevant laws, rules and regulations are directly distributed to all appropriate personnel, and losses attributable to non-compliance are factored into many of our incentive compensation calculations, thereby encouraging responsibility for compliance throughout our organization, including our mortgage loan origination operations. Our compliance with laws, rules and regulations is reviewed, not only by our own legal and quality control department, but also by the warehouse lenders who finance our mortgage loans, the institutions that purchase our mortgage loans, the investment bankers, rating agencies and insurers that are involved in the securitization of our mortgage loans, and the regulating governmental agencies. Because of the national scope of our operations, we are continuously in one stage or another of an audit by one or more governmental agencies, and we do not believe that such audits have ever resulted in findings of material violations or the imposition of significant penalties.

New Areas of Regulation

In the past year, a number of laws, regulations and guidelines have been proposed or enacted at the federal, state and local government levels that address responsible lending practice and impose new standards on loan products offered to non-prime borrowers or borrowers seeking nontraditional mortgage products. 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, AAMR 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, several states have enacted legislation to increase the responsibilities of mortgage lenders and mortgage brokers, including increased underwriting standards for certain loan products and increased licensing and regulatory requirements for mortgage industry participants. Furthermore, numerous federal and state legislative proposals have been offered to curb abusive lending and address perceived market failures regarding non-prime lending and nontraditional mortgage loan products, including proposals for suitability standards, mortgage broker fiduciary duties or agency obligations, new underwriting requirements, restrictions on specific loan products or terms, additional fraud protections, and enhanced assignee liability. Also, the regulator of Fannie Mae and Freddie Mac has stated his intention to require such government sponsored enterprises to

discontinue buying loans, either directly or indirectly through private-label mortgage backed securities, if the loans do not comply with regulatory guidance regarding nontraditional mortgage products and non-prime loans. In addition, federal and state legislators and regulators have proposed moratoria on foreclosures, forbearance requirements and other policies that may restrict the ability of servicers to collect nonperforming loans and realize on collateral.

The full impact of these proposed and enacted laws, regulations and guidance on the industry and us is uncertain at this time. Adoption of these laws, regulations and guidelines could have a material adverse impact on our loan origination volume, results of operations, financial condition and business prospects.

Regulatory and legal requirements are subject to change, making our compliance more difficult and/or expensive, or otherwise restricting our ability to conduct our business as it is now conducted. In particular, federal, state and local governments have become more active in the consumer protection area in recent years. For example, the federal Gram-Leach-Bliley financial reform legislation imposes additional privacy obligations on us with respect to our applicants and borrowers. Several states are also considering adopting privacy legislation In addition, numerous federal, state and local laws, rules and regulations have been adopted, or are under consideration, that are intended to eliminate so-called predatory lending products and practices.

The federal Home Ownership and Equity Protection Act (HOEPA) identifies a category of mortgage loans and subjects such mortgage loans to restrictions not applicable to other mortgage loans. Mortgage loans subject to HOEPA consist of mortgage loans on which certain points and fees or the annual percentage rate (APR) exceed specified levels. Liability for violations of applicable law with regard to mortgage loans subject to HOEPA would extend not only to us, but to the purchasers of our mortgage loans as well. We generally do not make mortgage loans that are subject to HOEPA because the purchasers of our mortgage loans and/or the lenders that provide financing for our mortgage loan origination operations do not want to purchase or finance such mortgage loans. On October 1, 2002, the APR and points and fees thresholds for determining mortgage loans subject to HOEPA were lowered, thereby expanding the scope of mortgage loans subject to HOEPA. We anticipate that we will continue to avoid making mortgage loans subject to HOEPA, and the lowering of the thresholds beyond which mortgage loans become subject to HOEPA may prevent us from making certain mortgage loans and may cause us to reduce the APR or the points and fees on mortgage loans that we do make. If we decide to relax our restrictions on mortgage loans subject to HOEPA because the purchasers of our mortgage loans and/or the lenders that provide financing for our mortgage loan origination operations relax their restrictions, we will be subject to greater risks for actual or perceived non-compliance with HOEPA and other applicable laws, including demands for indemnification or mortgage loan repurchases from our lenders and mortgage loan purchasers, class action lawsuits and administrative enforcement actions.

Laws, rules and regulations have been adopted, or are under consideration, at the state and local levels that are similar to HOEPA in that they impose certain restrictions on mortgage loans on which certain points and fees or the APR exceeds specified thresholds, so-called high cost mortgage loans. The restrictions include prohibitions on steering borrowers into mortgage loans with high interest rates and away from more affordable products, selling unnecessary insurance to borrowers, flipping or repeatedly refinancing mortgage loans and making mortgage loans without a reasonable expectation that the borrowers will be able to repay the mortgage loans. Compliance with some of these restrictions requires lenders to make subjective judgments, such as whether a mortgage loan will provide a net tangible benefit to the borrower. 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.

In general, it is against our policy to engage in the practices prohibited by these laws, and we could originate high cost mortgage loans that comply with all the requirements of these laws. However, we have generally avoided 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 of these laws, rules and regulations may prevent us from making certain mortgage loans that we might 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.

Yield Spread Premiums

A substantial portion of our mortgage loans are originated through independent mortgage brokers. Mortgage brokers provide valuable services in the mortgage loan origination process and are compensated for their services by receiving fees on mortgage loans. Brokers may be paid by the borrower, the lender or both. If a borrower cannot or does not want to pay the mortgage broker s fees directly, the mortgage loan can be structured so that the mortgage broker s fees are paid from the proceeds of the mortgage loan, or the mortgage loan can provide for a higher interest rate or higher fees to the lender. The increased value of a mortgage loan with a higher interest rate enables the lender to pay all or a portion of the broker s compensation. This form of compensation is often referred to as a yield spread premium. Regardless of its label or method of calculation, the payment is intended to compensate the broker for the services actually performed and the facilities actually provided. Competitive forces currently demand that we pay mortgage brokers yield spread premiums on many of the mortgage loans we originate.

The federal Real Estate Settlement Procedures Act (RESPA) prohibits the payment of fees for the mere referral of real estate settlement service business. This law does permit the payment of reasonable value for services actually performed and facilities actually provided unrelated to the referral. On September 18, 2002, the Eleventh Circuit Court of Appeals issued a decision in *Heimmermann v. First Union Mortgage Corp.* that reversed the court s earlier decision in *Culpepper v. Irwin Mortgage Corp.,* in which the court found the yield spread premium payments received by a mortgage broker to be unlawful per se under RESPA. The Department of Housing and Urban Development (HUD) had responded to the *Culpepper* decision by issuing a policy statement (2001-1) taking the position that lender payments to mortgage brokers, including yield spread premiums, are not per se illegal. The *Heimmermann* decision eliminated a conflict that had arisen between the Eleventh Circuit and the Eighth and Ninth Circuit Courts of Appeals, with the result that all federal circuit courts, which have considered the issue have aligned with the HUD policy statement and found that yield spread premiums are not prohibited per se. If other circuit courts that have not yet reviewed this issue disagree with the *Heimmermann* decision, there could be a substantial increase in litigation regarding lender payments to brokers and in the potential costs of defending these types of claims and in paying any judgments that might result.

Licensing

We are licensed or registered (or exempt from licensing or registration requirements) by the relevant governmental agencies in all 50 states and in the District of Columbia to originate first and junior priority mortgages.

In the future, we may consider procuring a federal depository institution charter or acquiring an institution with such a charter in order to reduce the volume of state and local laws and regulations with which we must comply. If we proceed with this strategy, however, we will also be subject to a variety of other regulations with which we do not currently have to comply.

AHL is required to file annual audited financial statements with certain U.S. State and Canadian provincial mortgage licensing authorities, and is currently operating under oral and written waivers of such filing requirements. AHL expects to satisfy such filing requirements at or about the time that this Form 10-K is filed with the SEC; however, if such filings are significantly delayed, AHL s mortgage lending and servicing licenses may be suspended or revoked in one or more such jurisdictions.

Environmental

AHL is required to file annual audited financial statements with certain U.S. State and Canadian provincial mortgage licensing authorities, and is currently operating under oral and written waivers of such filing requirements. AHL expects to satisfy such filing requirements at or about the time that this Form 10-K is filed with the SEC; however, if such filings are significantly delayed, AHL s mortgage lending and servicing licenses may be suspended or revoked in one or more such jurisdictions.

Employees

We employed approximately 4,200 and 2,700 full-time employees as of December 31, 2006 and May 31, 2007, respectively. None of our employees are represented by a union or covered by a collective bargaining agreement. We believe our relations with our employees are satisfactory, despite the current challenges our Company and the non-prime industry face. We have a policy of conducting a comprehensive employee opinion survey approximately every 24 months. We have conducted five such surveys so far and have won four Peter Barron Stark Awards for Workplace Excellence in 2000, 2001, 2003, and 2005.

Executive Officers

Our executive officers as of December 31, 2006 and their ages as of July 31, 2007 are as follows:

James A. Konrath, 61, co-founded our company and has served as our Chairman of the Board and Chief Executive Officer since its formation in 1990. In addition, Mr. Konrath served as our President from 1990 to 1998. Prior to founding our company, Mr. Konrath was the President and Chief Executive Officer of Security Pacific Financial Services, Inc., where he managed over 1,900 people in more than 300 consumer finance offices, from 1986 to 1989. From 1983 to 1986, Mr. Konrath was the President and Chief Executive Officer of Security Pacific Housing Services, where he founded a new subsidiary focused on manufactured housing mortgage loans. Mr. Konrath earned his Bachelor of Arts degree in Accounting with a minor in Economics from the University of Wisconsin Whitewater in 1969.

Joseph J. Lydon, 48, has served as our President and Chief Operating Officer since May 1998 and as a director since July 2004. From February 1997 until that time, Mr. Lydon was our Director of Sales and Marketing. From 1993 to 1997, Mr. Lydon was the Executive Vice President for the western division of Ford Consumer Finance, a division of The Associates First Capital Corporation. From 1977 to 1993, Mr. Lydon worked at Security Pacific Financial Services, Inc. where he ultimately became a Senior Vice President with full profit and loss responsibilities and oversight of six divisions. Mr. Lydon earned his Bachelor of Science degree in Management from Pepperdine University in 1991 and a Master of Science in Executive Leadership degree from University of San Diego in 2007.

Stuart D. Marvin, 47, has served as our Executive Vice President since April 2005. Mr. Marvin oversees finance, capital markets and corporate communications. He has over 22 years of experience in the financial services and non-prime mortgage industry. Prior to joining Accredited, he was President, Corporate Operations and Chief Financial Officer for Aegis Mortgage Corporation and a partner at PriceWaterhouse Coopers, LLP focusing on mortgage banking and financial institutions. Mr. Marvin is a Certified Public Accountant and earned a Bachelor of Science degree with honors in accounting from Jacksonville (FL) University in 1982.

Jeffrey W. Crawford, 52, has served as our Director of Operations since January 1999. Mr. Crawford oversees the corporate underwriting, mortgage loan closing, post-closing and asset management/servicing departments. From 1994 to 1999, Mr. Crawford held various positions with Ford Consumer Finance, the most recent of which was Senior Vice President-Division Manager. From 1983 to 1994, Mr. Crawford was the Branch Manager, Director of Credit Scoring Systems, Assistant Vice President Administration and Vice President of Consumer Administration for Security Pacific Financial Services, Inc. Mr. Crawford earned his Bachelor of Science degree in Business from Iowa State University in 1977.

David E. Hertzel, 52, has served as our General Counsel since December 1995. Mr. Hertzel is responsible for regulatory compliance, licensing and qualification, corporate record-keeping, litigation, contract negotiation and all other legal matters. Prior to joining us, Mr. Hertzel was Vice President and Senior Counsel of American Residential Mortgage Corporation, from 1991 to 1994. From 1988 to 1991, he was Vice President and Senior Counsel of Imperial Savings Association. Mr. Hertzel earned his Juris Doctor degree from the University of Utah College of Law in 1980 and is a member of the State Bar of California.

Executive Offices

Our principal executive offices are located at 15253 Avenue of Science, San Diego, California 92128 (telephone number (858) 676-2100).

Access to SEC Filings

The public may read and copy any materials we file with the SEC at the SEC s Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330.

Our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act will be accessible at no cost on our website, http://www.accredhome.com, as soon as reasonably practicable after those reports have been electronically filed or submitted to the SEC. These filings, as well as reports, proxy and information statements and other information regarding issuers that file electronically with the SEC, will also be accessible on the SEC s website, http://www.sec.gov.

ITEM 1A. Risk Factors

You should carefully consider the following risks, together with other matters described in this Form 10-K 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-K (including certain of the following risk factors) constitute forward-looking statements. Please refer to the section entitled Forward-Looking Statements on page 6 of this Form 10-K.

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 quarter 2007. As of mid-June 2007, more than 50 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 the first seven months of 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);

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 10);

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 10);

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

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 16);

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

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 24);

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

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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 28);

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 30); and

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 31).

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.

The non-prime lending industry is experiencing increases in mortgage loan defaults and sharp declines in the market for mortgages originated, which have led us to experience losses on the loans we originate and significant reductions in our liquidity, and have required us to obtain waivers of compliance with certain covenants under our credit facilities.

In connection with the challenges facing the non-prime lending industry, several of our competitors have recently stopped originating loans or sought protection under bankruptcy laws. Unless the values of our mortgage products cease their decline, and we are able to obtain new sources of liquidity and waivers and modification of the covenants in our credit facilities, we may suffer a similar fate.

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 or a net loss payment obligation, 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.

From January 1, 2007 to March 15, 2007, we paid approximately $190 million of margin calls by our lenders, two-thirds of which occurred in the four weeks prior to March 15, 2007. To bolster liquidity and minimize our exposure to margin calls, in March 2007, the Company sold $2.7 billion in loans held for sale at a substantial discount. (See Item 7. Management s Discussion and Analysis of Financial Conditions and Results of Operations Recent Developments.)

We may not meet the continued listing criteria for the NASDAQ Capital Market, which could materially and adversely affect the price and liquidity of our common stock, our business and our financial condition.

On March 15, 2007, we received a notice from the staff of NASDAQ stating that the Company is not in compliance with Marketplace Rule 4310(c)(14) because it had not filed its Annual Report on Form 10-K for the year ended December 31, 2006 on a timely basis. Due to such noncompliance, the Company s common stock may be subject to potential delisting. We requested a hearing before the NASDAQ Listing Qualifications Panel to appeal the NASDAQ staff s determination and to present our 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, we received an additional deficiency notice from the staff of NASDAQ because the Company had not filed its Quarterly Report on Form 10-Q for the quarter ended March 31, 2007. The additional notice stated that such failure could serve as an additional basis for the delisting of the Company s securities from NASDAQ.

On June 20, 2007 the NASDAQ Listing Qualifications Panel (the Panel) granted the Company s request for continued listing of the Company s securities on The NASDAQ Global Select Market. The Company s continued listing is subject to certain conditions, including compliance with extended deadlines for the filing of the Company s Form 10-K for the fiscal year ended December 31, 2006 and of the Form 10-Q for the quarter ended March 31, 2007 with the Securities and Exchange Commission (SEC).

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

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

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. If, after a mortgage loan is sold, there is identification of the breach of any such representation or warranty, we may be obligated to repurchase the mortgage loan and bear any associated loss directly, or we may be obligated to indemnify the purchaser against any such losses, either of which could reduce our cash available for operations and liquidity. We may also be obligated to repurchase such a loan in the event of default by the borrower. 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. Subsequent to December 31, 2006, certain investors became more aggressive regarding the identification, notification and collection of repurchase requests to the Company. During the five months ended May 31, 2007, we repurchased approximately $152 million in mortgage loans and paid $39.2 million in cash settlements to eliminate the requirement to repurchase mortgage loans in the future from investors. The Company when settling repurchase requests often receives a release from the investor from all future repurchase requests or obligations.

With the exception of the Early Payment Default warranty, which applies for a defined period, we are subject to these representations and warranties for the life of the mortgage loan, which address among other things:

- fraud in the origination process;
- the borrower will not fail to make a specified number of payments (typically one or two) after the investor purchases the loan (an Early Payment Default);
- 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.

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 also create allowances to provide for defective mortgage loans in our financial statements.

We cannot assure you that we will not make mistakes and breach such representations and warranties, or that certain employees will not deliberately violate our lending policies. In addition, the number of mortgage loans that we are required to repurchase will increase as a result of our merger with Aames, since we assumed their repurchase obligations upon the closing of the merger. We cannot assure you that losses associated with defective mortgage loans will not harm our results of operations or financial condition.

We may not be able to continue to sell and securitize our mortgage loans.

A substantial portion of our revenues comes from the gains on sale generated by sales of pools of our mortgage loans as whole mortgage loans. We typically have sold mortgage loans to a number of institutional purchasers, some of which may be frequent, repeat purchasers, and others of which may make only one or a few purchases from us. In the year ended December 31, 2006, 29.9% and 12.1% of the total principal amount of whole loan sales were made to HSBC Mortgage Services Inc. and The CIT Group, respectively. In April 2007, HSBC Mortgage informed the Company that they will no longer be purchasing any more non-prime loans in the future. In July 2007, the CIT Group announced that they will no longer be purchasing non-prime loans in the future. Moreover, we cannot assure you that we will continue to have any purchasers for our mortgage loans on terms and conditions that will be profitable to us. Also, even though our mortgage loans are generally marketable to multiple purchasers, certain mortgage loans may be marketable to only one or a few purchasers, thereby increasing the risk that we may be unable to sell such mortgage loans at a profit.

There has been a severe lack of demand recently for the purchase of whole loan pools of non-prime mortgage loans. For example, Freddie Mac announced in February 2007 that it will no longer purchase non-prime mortgage loans that include teaser rates and will limit the use of low documentation loans in connection with these products. As a result, we have been limited in the mortgage loans we can sell, and these

loans have remained part of our portfolio, financed primarily through our credit facilities, which are short-term financing sources. As discussed below, these facilities include margin provisions to ensure the adequacy of the pledged collateral, and margin calls made by our lenders during the first quarter of 2007 have reduced the amount of available capital. (See Item 7. Management s Discussion and Analysis of Financial Conditions and Results of Operations Recent Developments.)

We also often rely on our ability to securitize our mortgage loans to realize a greater percentage of the full economic value of the mortgage loans. We cannot assure you, however, that we will continue to be successful in securitizing mortgage loans. Our ability to complete securitizations of our mortgage loans will depend upon a number of factors, many of which are beyond our control, including conditions in the credit and securities markets generally, conditions in the asset-backed securities market specifically, the availability of credit enhancements 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 conditions within the non-prime mortgage industry, rating agencies, financial guarantee insurers and investors have recently begun to, and may continue to in the future, require additional credit enhancement to support the securities sold in securitizations of non-prime mortgage loans. This requirement generally has the effect of reducing our earnings and increasing the overall expense of executing securitizations.

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

The current challenges our Company and the non-prime industry face has had a very negative effect on our employee morale. We depend upon our wholesale account executives and retail mortgage loan officers to attract borrowers by, among other things, developing relationships with financial institutions, other mortgage companies and brokers, real estate agents, borrowers, management, and others. We believe that these relationships lead to repeat and referral business. The market for skilled executive officers, account executives and mortgage loan officers has historically been highly competitive and has experienced a high rate of turnover. The challenges we face to retain qualified management personnel may be extremely disruptive to our business. We currently recruit college graduates to participate in our management trainee program. If we are unable to retain those trainees for a sufficient period following their training, we may be unable to recapture our costs of training and recruitment. In addition, if a manager leaves our company there is an increased likelihood that other members of his or her team will follow. In addition, attrition of qualified account executives and mortgage loan officers may hinder our ability to continue to originate quality mortgage loans that we are able to sell for a profit, which will reduce our revenues, and increase hiring and retention costs.

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 assurances the executives will 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.

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 operating environment in the non-prime industry (See Item 7. Management s Discussion and Analysis of Financial Conditions and Results of Operations Recent Developments) 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. Also, unless adequate capital is provided to us to continue operations, we may not be able to sustain operations or have enough future taxable income to use the deferred tax assets we acquired. Based upon these events and circumstances, we did establish a valuation allowance against certain tax assets as of December 31, 2006.

Our business requires a significant amount of cash and if it is not available our business will be significantly harmed.

Our primary sources of cash have historically been our warehouse credit facilities, our commercial paper program, our residual financing and servicing financing facilities and the proceeds from the sales and securitizations of our mortgage loans. 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. Our warehouse and commercial paper program credit facilities also require us to observe certain financial covenants, including the maintenance of certain levels of cash and general liquidity in our company.

As of December 31, 2006, we financed substantially all of our mortgage loans through eight separate warehouse lenders and our commercial paper program. These facilities generally have a renewable, one-to-two year term. Because these are short-term commitments of capital, the lenders may respond to market conditions, which may favor an alternative investment strategy for them, making it more difficult for us to secure continued financing.

The Company, on March 30, 2007, amended the Amended and Restated Master Repurchase Agreement, dated as of December 30, 2005, with Credit Suisse First Boston Mortgage Capital LLC (CSFB), and entered into a Master Repurchase Agreement with Wachovia Bank, N.A. (Wachovia). Under the amended agreement with CSFB, the term of the CSFB repurchase facility was extended through March 31, 2008 and the maximum committed amount able to be borrowed remained at $600 million. Under the agreement with Wachovia (which was amended on May 1, 2007 and July 5, 2007), the maximum amount the Company is able to borrow is $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. Pursuant to the Loan Agreement, MIF extended term loans guaranteed by the Company in an aggregate principal amount of $230,000,000. 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.

Utilizing proceeds obtained from the sale of loans in the first quarter of 2007 and proceeds from the Farallon term note, Accredited repaid substantially all the debt then outstanding on its warehouse credit facilities. Concurrent with the repayment of these facilities, Accredited terminated many of the warehouse credit lines available to the Company and obtained waivers of certain covenants on the remaining facilities. In exchange for the waivers granted, Accredited agreed that it would not seek additional borrowings under these credit agreements. There were no amounts outstanding under these facilities at July 31, 2007.

In addition, by May 31, 2007, based upon market conditions adversely impacting the salability of any asset-backed commercial paper notes collateralized by non-prime mortgage loans, the Company voluntarily terminated the program and repaid all subordinated notes and SLNs. (See Item 7. Management s Discussion and Analysis of Financial Conditions and Results of Operations Recent Developments.)

The timing of our mortgage loan dispositions (which are periodic) is not always matched to the timing of our expenses (which are continuous). This requires us to maintain significant levels of cash to maintain acceptable levels of liquidity. When we securitize our mortgage loans or sell our mortgage loans with a retained interest, we may not receive any amounts in excess of the principal amount of the mortgage loan for up to 12 months or longer. Further, any decrease in demand in the whole mortgage loan market, like we have experienced recently (See Item 7. Management s Discussion and Analysis of Financial Conditions and Results of Operations Recent Developments), such that we are unable to timely and profitably sell our mortgage loans could inhibit our ability to meet our liquidity demands.

We have operated under waivers provided by lenders with respect to certain covenants in our credit facilities. A failure to obtain waivers or renewals of such waivers to their covenants can result in the lenders ability to immediately accelerate repayment.

Certain of our lenders have waived certain covenants which include:

- maintaining positive net income; and

- filing our Annual Report on Form 10-K in a timely fashion.

There can be no assurance that we will be able to obtain future waivers or new waivers if covenants are not met, or that we will be able to obtain waivers on favorable terms. In the event such amendments or waivers are required and we are unable to obtain them, our lenders will have the right to accelerate our repayment obligations under our credit facilities and it could adversely impact our ability to fund mortgage loans and jeopardize our ability to continue as a going concern.

Our credit facilities contain covenants that restrict our operations and may impact our ability to fund mortgage loans, grow our business and increase revenues. A failure to obtain waivers to these covenants could result in immediate acceleration and loss of liquidity. Material adverse change covenants and cross default provisions magnify the consequences of any failure to maintain full compliance with all covenants.

Our warehouse credit facilities, residual financing facilities and servicing financing facilities typically contain extensive restrictions and covenants that may interfere with our ability to obtain financing or engage in other business activities, and significantly harm our business, financial condition, liquidity and results of operations. The covenants and restrictions address, among other things:

- minimum profitability;

- liquidity and net worth requirements;

- limitations on indebtedness to net worth ratios;

- asset quality and mortgage loan performance tests;

- inter-company dividends;

- investments and acquisitions;

repurchase or redemption of capital stock;

mergers or consolidations or other changes of control;

mortgage loan attributes;

time periods for holding mortgage loans;

maximum cumulative losses;

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

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

material adverse change restrictions.

If we fail to meet or satisfy any of these covenants or restrictions, 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.

As a result of our merger with Aames, our management has been and may continue to be distracted from their focus on our business and operations in order to attend to merger-related matters.

There is a significant degree of difficulty and management distraction inherent in the process of integrating the Accredited and Aames businesses. The process of integrating operations has 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 devote considerable amounts of time to this integration process, which will decrease the time they will have to manage our business, service existing borrowers and vendors, attract new borrowers and develop new products or strategies. If our senior management is not able to effectively manage the integration process, or if any significant business activities are interrupted as a result of the integration process, our business could suffer.

Failure to successfully integrate Aames into Accredited s operations could reduce our profitability.

We have spent considerable resources to integrate the Aames operations, including the combination of sales and marketing efforts, and anticipate significant additional efforts will be necessary. If we are not able to successfully integrate the business and operations of Aames, or the state of our industry does not improve, our expectations of future results of operations may not be met.

Members of our management have devoted significant attention and resources to integrating the business and operations of Aames. Continued diversion of management s attention or difficulties in the transition process could have a material adverse impact on us. Additionally, personnel have left and have been terminated because of the merger. Employee terminations or resignations or facility closures may require us to make severance or other payments and may result in related litigation. The integration process could result in the disruption of our ongoing business or inconsistencies in standards, controls, procedures and policies that adversely affect our ability to maintain relationships with customers, employees and others with whom we have business dealings. The integration process may also result in additional and unforeseen expenses and may have unanticipated adverse results relating to our existing businesses.

The benefits we anticipated from the merger, such as cost savings and expense reductions achieved by eliminating duplicative operations, outside services and redundant staff and by consolidating facilities, depend on our ability to successfully integrate the businesses and operations of Accredited and Aames and future market conditions. Even if we are able to integrate operations, there can be no assurance that these expected cost savings, expense reductions and synergies will be achieved, particularly in light of the current challenges the non-prime mortgage industry faces. The failure to achieve synergies could have a material adverse effect on the business results of operations and financial condition of the combined company.

The pledge of the mortgage loans, servicing assets and the economic residual interests that we retain may limit our ability to obtain additional sources of financing.

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, which together represent substantially all of our assets, to warehouse and repurchase facility providers. Additionally, on March 30, 2007, the Company completed a $230 million term financing with MIF Farallon, in which the company pledged all of its unencumbered assets to secure the term facility (See Item 7. Management s Discussion and Analysis of Financial Conditions and Results of Operations Recent Developments). To the extent that we are not successful in maintaining, replacing or obtaining alternative financing sources on acceptable terms or raise additional capital, we may have to limit our mortgage loan originations or sell mortgage loans earlier than intended. Limiting our originations or earlier sales of our mortgage loans would adversely affect the results of our operations and restrict our ability to repay our outstanding debt and could negatively impact the value of our stock.

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 our 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.

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

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

- Commencing with the quarter ending December 31, 2004, 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, 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, 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 REIT to the extent that such subsidiaries are restricted by law or agreement from distributing such income to 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 REIT s Series A Preferred Shares in those four quarters.

If 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 REIT s common shares until it is in compliance with all of the covenants as of the end of two successive quarters.

We own all of REIT s common shares and rely heavily on the dividend received from REIT on the common shares. If 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 REIT which will adversely affect our business and operations. In 2006, the aggregate dividend we received on the common shares of REIT was approximately $200 million.

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

The economic residual interests for securitizations that we retain in our REIT 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 finance borrowers with lower credit ratings. The non-prime mortgage loans we originate generally have higher delinquency and default rates than prime mortgage loans, which could result in losses on mortgage loans that we hold or that we are required to repurchase, the loss of our servicing rights and damage to our reputation as a mortgage loan servicer.

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 7.2% at December 31, 2006. 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.

A sustained reduction of our mortgage origination volume could harm us financially.

The amount of mortgage loans we originate has reduced substantially in recent periods. This is a result of decreased demand for mortgage loans by investors which is primarily the result of increased delinquencies and early payment defaults, as well as general perceptions about the non-prime market. Additionally, demand among borrowers for mortgage products has decreased significantly in recent months as the real estate market has cooled. Any sustained period of reduced origination volume is likely to significantly harm our business.

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, 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. As we seek to expand our business further, we will face a significant number of additional competitors, many of whom will be well established in the markets we seek to penetrate. 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. A material expansion of the government sponsored entities involvement in the market to originate or purchase non-prime mortgage loans could 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 adversely affect investor perceptions.

The intense competition in the non-prime mortgage industry has also 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.

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.

Any future economic slowdown could increase delinquencies, defaults and foreclosures and reduce 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 originate 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 reduce 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 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 our future mortgage loan sales and securitizations and also our ability to finance our mortgage loan originations.

A future increase in interest rates could result in a reduction in our mortgage loan origination volumes, 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 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, or two, three or five years. 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 5.78% during the year ended December 31, 2006.

- When we securitize mortgage loans or sell mortgage loans with retained interests, the value of and the income we receive from the mortgage loans held for investment subject to portfolio-based accounting and the mortgage-related securities 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 mortgage loans and mortgage-related securities is based on the difference between the fixed rates payable on the mortgage loans for the first two or three years, and an adjustable LIBOR-based yield payable to the senior security holders or mortgage loan purchasers. We also have interest rate risk when the mortgage loans become adjustable after their two or three 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 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 year ended December 31, 2006, 15% and 12% of the principal balance of the mortgage loans we originated were collateralized by properties located in California and Florida, respectively. At December 31, 2006, 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.

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 held for investment subject to portfolio-based accounting 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 mortgage loans held for investment 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 or mortgage loan purchasers. This excess amount is also calculated after deduction of servicing fees and any other specified expenses related to the sale or 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 or mortgage loan purchasers;
- 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 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 mortgage loans held for investment.

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

Historically, we have experienced rapid growth that has placed, and will continue to place, certain pressures on our management, administrative, operational and financial infrastructure. In addition to growth by direct expansion, we have also grown 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, 2002, we had 1,294 employees and by December 31, 2006, we had approximately 4,200 employees (1,177 of which were attributable to our acquisition of Aames). Many of these employees have very limited experience with us and a limited understanding of our systems and controls. Given the recent slowdown in origination volume and in order to preserve capital we have made significant reductions to our number of employees. As of May 31, 2007, we had approximately 2,700 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.

An interruption in, or breach of, our information systems may result in lost business.

We rely heavily upon communications and information systems to conduct our business. Changes in our size of operations or mortgage loan production may require significant changes in these systems. 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.

Our ability to effectively interface with our brokers, borrowers and other third parties, and efficiently process mortgage loan applications and closings strongly affects our 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 that are cost-efficient to our business. 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. As these requirements increase in the future, we will have to fully develop these technological capabilities to remain competitive or our business will be significantly harmed.

AHL s mortgage lending and servicing licenses may be suspended or revoked in one or more states or provinces if the filing of AHL s audited financial statements is significantly delayed.

AHL is required to file annual audited financial statements with certain U.S. state and Canadian provincial mortgage licensing authorities, and is currently operating under oral and written waivers of such filing requirements. AHL expects to satisfy such filing requirements at or about the time that this Form 10-K is filed with the SEC; however, if such filings are significantly delayed, AHL s mortgage lending and servicing licenses may be suspended or revoked in one or more such jurisdictions.

If we are unable to maintain and expand our network of independent brokers, our mortgage loan origination business will decrease.

A significant majority of our originations of mortgage loans comes 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 in our efforts to expand our broker networks. Accordingly, we cannot assure you that we will be successful in maintaining our existing relationships or expanding our broker networks, the failure of which could significantly harm our business, financial condition, liquidity and results of operations.

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 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 recent 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 supersedes 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 3 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. For instance, if various plaintiffs prevail on claims that prescreened offers of credit do not qualify as firm offers of credit under the FCRA, and thus that we are not authorized to access certain consumer credit reports in relation to such offers, then our business practices and ability to offer and close certain lines of credit would be impaired and our revenues, results of operations, business and profitability could be harmed.

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, again resulting in a loss of our profit on the mortgage loan; or

- after we have securitized the mortgage loan or sold the mortgage loan in a sale, 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 year ended December 31, 2006, 29% 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 year ended December 31, 2006, originations of interest-only mortgage loans totaled $2.1 billion, or 13.6%, 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 reduce our earnings in connection with our reliance on cash-out refinancings as a significant source of our origination volume.

During the year ended December 31, 2006, approximately 61% of our mortgage loan production volume consisted of cash-out refinancings. This concentration increases the risk that our earnings will be reduced if interest rates rise or the prices of homes decline, which would reduce the demand and production volume for this type of refinancing. 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 result in a decrease in our mortgage loan production volume from that origination source. Therefore, our reliance on cash-out refinancings as a significant source of our origination volume subjects 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, 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 our securitizations structured as financings and from our 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 we originate mortgage loans in all 50 states, in the District of Columbia and Canada, 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 our operations continue to grow, 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, AAMR 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 our ability to offer loan products, reduce the pool of applicants who are eligible to obtain loans and restrict the volume and profitability of our loan origination, investment and servicing activities, in addition to increasing our exposure to risks of noncompliance with governing law 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 from whom we obtain mortgage loans 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 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.

Risks Related to Our Capital Structure

Our guarantee of the Series A preferred shares of the REIT is senior to claims of our common stockholders.

Our guarantee of dividend and principal payments on the Series A preferred shares of the REIT is subordinate to all of our existing and future indebtedness but is senior to our common stock. As a result, upon any distribution to our creditors in a bankruptcy, liquidation or reorganization or similar proceeding, the holders of the Series A preferred shares will be entitled to be paid in full under the guarantee before any payment may be made to holders of our common stock.

Our right to participate in distribution of assets of our subsidiaries upon the latter s liquidation or reorganization will be subject to proper claims of the subsidiary s creditors.

We are a holding company and our assets consist primarily of investments in our subsidiaries. Substantially all of our consolidated liabilities have been incurred by our subsidiaries. Therefore, our right to participate in the distribution of assets of any subsidiary upon the latter s liquidation or reorganization will be subject to prior claims of the subsidiary s creditors, including trade creditors, except to the extent that we may be a creditor with recognized claims against the subsidiary, in which case our claims would still be subject to the prior claims of any secured creditor of such subsidiary and of any holder of indebtedness of such subsidiary that is senior to that held by us. Additionally, on March 30, 2007, the Company entered into a $230 million term loan with Farallon, which provided Farallon rights to all unencumbered assets of the Company (See Item 7. Management s Discussion and Analysis of Financial Conditions and Results of Operations Recent Developments).

If the REIT fails to maintain its status as a real estate investment trust, the REIT will be subject to federal and state income tax on taxable income at regular corporate rates, and the value of our common stock may be adversely impacted as a result.

The REIT was organized to qualify for taxation as a real estate investment trust under the Internal Revenue Code of 1986, as amended (the Code). The REIT has conducted, and intends to continue to conduct, its operations so as to qualify as a real estate investment trust. Qualification as a real estate investment trust involves the satisfaction of numerous requirements, some on an annual and some on a quarterly basis, established under highly technical and complex provisions of the Code for which there are only limited judicial and administrative interpretations and involves the determination of various factual matters and circumstances not entirely within the REIT s control. For instance, in order to qualify as a real estate investment trust, the REIT s shares of beneficial interest must be beneficially owned by 100 or more persons during at least 335 days of a taxable year of twelve months (other than the first year for which an election to be a real estate investment trust has been made) or during a proportionate part of a shorter taxable year. Also, no more than 50% of the value of the outstanding shares of beneficial interest of the REIT may be beneficially owned, directly or indirectly, by five or fewer individuals (as defined in the Code to include certain entities) (the Ownership Test). Furthermore, each year the REIT must distribute to its shareholders at least 90% of the REIT s taxable income (the Annual Distribution Requirements). We cannot assure you that the REIT will at all times satisfy these rules and tests.

If the REIT were to fail to timely meet the Annual Distribution Requirements, satisfy the Ownership Test or otherwise qualify as a real estate investment trust in any taxable year, the REIT would be subject to federal and state income tax, including any applicable alternative minimum tax, on its taxable income at regular corporate rates. Moreover, unless entitled to relief under certain statutory provisions, the REIT would also be disqualified from treatment as a real estate investment trust for the four taxable years following the year during which the qualification is lost. This treatment would reduce the REIT s net earnings and cash flow available for distribution to shareholders, including to us as holder of the REIT s common shares, because of its additional tax liability for the years involved. Additionally, distributions to shareholders would no longer be required to be made by the REIT. Accordingly, the REIT s failure to qualify as a real estate investment trust could have a material adverse impact on our financial results and the value of the common stock held by our stockholders.

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

The market price of our common stock has been and in the future may be volatile.

The market price for our common stock has fluctuated due to a number of factors, including:

- changes in housing costs;
- variations in quarterly operating results;
- investor perceptions of our company and the mortgage industry generally (including the non-prime and nonconforming mortgage industry);
- the issuance of new equity securities pursuant to a future offering;
- changes in interest rates;
- the depth and liquidity of the market for our common stock;
- general economic and other national conditions and the impact they may have on the operating assets of the Company;
- competitive developments, including announcements by us or our competitors of new products or services or significant contracts, acquisitions, strategic partnerships, joint ventures or capital commitments; and

- changes in financial estimates and forecasts published by securities analysts, or changes in ratings.

We can make no assurances that the market price for our common stock will not continue to make substantial fluctuations. In addition, renewed terrorist attacks, or threats of attacks, may contribute to global unrest, an economic slowdown and to instability in the U.S. and other global equity markets. All of these factors may increase the volatility of our stock price.

Some provisions of our certificate of incorporation and bylaws may deter takeover attempts, which may limit the opportunity of our stockholders to sell their shares at a favorable price.

Some of the provisions of our certificate of incorporation and bylaws could make it more difficult for a third party to acquire us, even if doing so might be beneficial to our stockholders by providing them with the opportunity to sell their shares possibly at a premium over the then market price.

For example, our board of directors is divided into three classes. At each annual meeting of stockholders, the terms of approximately one-third of the directors will expire, and new directors will be elected to serve for three years. The term of the first class expires at the 2007 annual meeting of stockholders, the term of the second class expires in 2008, and the term of the third class expires in 2009. Thus, it will take at least two annual meetings to effect a change in control of our board of directors because a majority of the directors cannot be elected at a single meeting, which may delay, discourage, prevent or make it more difficult or costly to acquire or effect a change in control, even if such a change in control would be favorable to our stockholders.

In addition, our certificate of incorporation authorizes the board of directors to issue up to 5,000,000 shares of preferred stock. The preferred stock may be issued in one or more series, the terms of which may be determined at the time of issuance by our board of directors without further action by the stockholders. These terms may include voting rights including the right to vote as a series on particular matters, preferences as to dividends and liquidation, conversion rights, redemption rights and sinking fund provisions. No shares of preferred stock are presently outstanding. The issuance of any preferred stock in the future could diminish the rights of holders of our common stock, and therefore could reduce the value of our common stock. In addition, specific rights granted to future holders of preferred stock could be used to restrict our ability to merge with, or sell assets to, a third party. The ability of our board of directors to issue preferred stock could delay, discourage, prevent or make it more difficult or costly to acquire or effect a change in control, even if such a change in control would be favorable to our stockholders.

Our bylaws contain provisions that require stockholders to act only at a duly-called meeting and make it difficult for any person other than management to introduce business at a duly-called meeting by requiring such other person to follow certain notice procedures.

Finally, we are also subject to Section 203 of the Delaware General Corporation Law which, subject to certain exceptions, prohibits a Delaware corporation from engaging in any business combination with any interested stockholder for a period of three years following the date that the stockholder became an interested stockholder. The preceding provisions of our certificate of incorporation and bylaws, as well as Section 203 of the Delaware General Corporation Law, could discourage potential acquisition proposals, or delay or prevent a change of control and prevent changes in our management, even if such things would be in the best interests of our stockholders.

Risk Factors Related to the Proposed Merger

Our businesses may be adversely impacted by the pending merger with Lone Star and if the pending merger is not consummated.

We have spent significant time and money preparing for the pending merger of the Company with Lone Star. There are uncertainties and other factors that may affect our business prior to consummation of the merger, including:

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

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

- risks that the proposed transaction disrupts our current plans and operations, and the potential difficulties for our employee retention as a result of the announcement of the merger; and
- the effect of the announcement of the merger on our customer relationships, operating results and business generally.

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

- the occurrence of any event, change or other circumstances that could give rise to the termination of the merger agreement;
- the inability to complete the merger due to the failure to obtain 50% of the shares through the tender offer, stockholder approval or the failure to satisfy other conditions to consummation of the merger;
- the failure of the merger to close for any other reason;
- risks that the proposed transaction disrupts our current plans and operations, and the potential difficulties for our employee retention as a result of (a) any delay of the completion of the merger, or (b) the completion of the merger; and
- the effect of the completion of the merger on our customer relationships, operating results and business generally.

In addition, the current market price of our common stock may reflect a market assumption that the merger will occur, and failure to complete the merger could result in a decline in the market price of our common stock.

ITEM 1B. Unresolved Staff Comments

None

ITEM 2. Properties

Our national headquarters is located in San Diego, CA and includes approximately 300,000 square feet in three buildings located in the same general area. The leases for these premises expire on various dates from April 14, 2008 to May 31, 2016. As of December 31, 2006, we leased an additional 126 properties in 25 states and two locations in Canada. These properties range in size from approximately 500 to 30,900 square feet with original lease terms varying from month-to-month to 8 years. We do not consider any specific leased location to be material to our operations. We believe that equally suitable alternative locations are available in all areas where we currently do business.

ITEM 3. Legal Proceedings
Legal Matters

In July 2007 we were served with a complaint, *National Community Reinvestment Coalition (NCRC) v. Accredited Home Lenders Holding Company [sic], et al.*, brought in the United States District Court for the District of Columbia. The complaint alleges that we engaged in a practice of discriminating against African-Americans and Latinos by requiring minimum property values of $100,000 on row homes for certain loan programs and prohibiting the use of row homes as collateral for certain other loan programs, without business justification for those restrictions. Plaintiff seeks compensatory and punitive damages, declaratory and injunctive relief, and recovery of attorneys fees and costs of suit. There has been no ruling on the merits of plaintiff s claims, and we intend to vigorously defend this action. The ultimate outcome of this matter and the amount of liability, if any, which may result is not presently determinable, but 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 July 2007, we were 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 we 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. We have not been served with the complaint and are 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, we were 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 us and members of our Board of Directors in connection with our entry into an Agreement and Plan of Merger with affiliates of Lone Star Fund V (U.S.) L.P. Plaintiffs seek injunctive relief, and recovery of attorneys fees and costs of suit. The *Korsinski* matter has been voluntarily dismissed by the plaintiff without prejudice. In the *Wan* matter, the plaintiff has filed a motion for preliminary injunction which is scheduled to be heard on August 24, 2007. A motion for class certification has not been filed. We intend to vigorously defend this matter. The ultimate outcome of this matter is not presently determinable, and while the Company does not believe it will suffer any material loss in this lawsuit, if the plaintiff is successful in obtaining injunctive relief, it could have a material adverse effect on the Company s financial position and results of operations.

In March 2007, we were 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 us and certain members of senior management. We are 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 is due 21 days after our 2006 audited financial statements are released, and our response to this complaint is due forty-five days after the complaint is filed. We intend to vigorously defend these matters. The ultimate outcome of these matters 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 thus matter will not have a material adverse effect on the Company s financial position or results of operations.

In March 2007, we were 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 we intend to vigorously defend this action. The ultimate outcome of this matter and the amount of liability, if any, which may result is not presently determinable, and legal counsel cannot express an opinion as to the extend 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, we 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 our merger with Aames Investment Corporation (AIC) and certain of its subsidiaries, we 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), a subsidiary of AIC) 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 we intend to vigorously defend this matter. The ultimate outcome of this matter and the amount of liability, if any, which may result is not presently determinable, and legal counsel cannot express an opinion as to the extend 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 merger referenced above, we 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 we intend to continue to vigorously defend this matter. The ultimate outcome of this matter and the amount of liability, if any, which may result, is not presently determinable, 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 merger referenced above, we 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 discussed below. The *Cooper* matter was transferred to the Central District of California and consolidated with the *Webb* matter by stipulation of counsel on September 29, 2006. A 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 we intend to continue to vigorously defend this matter. The ultimate outcome of this matter and the amount of liability, if any, which may result, is not presently determinable, 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 March 2006, we were 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 our 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, we removed the action to the United States District Court, District of Maryland. On May 15, 2006, we filed a motion to dismiss plaintiffs second cause of action alleging a violation of the Maryland Consumer Protection Act on the basis that full disclosure of the fees cannot be an unfair or deceptive trade practice, which motion was granted on December 4, 2006. On January 3, 2007, plaintiffs filed a Second Amended Complaint, alleging that our origination in Maryland of second lien loans with balloon payments was also a violation of the SMLL. On July 5, 2007, the court granted our 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 we 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 extend 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, we 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 us. 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 our motion to (1) dismiss with prejudice plaintiff s claim that our 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 us from those made against other defendants unaffiliated with us. Plaintiff s remaining claim is that our 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, we filed a Petition for Leave to Appeal with the Ninth Circuit Court of Appeals, seeking an immediate appeal from the Order granting class certification and a stay of the action in the District Court pending the outcome of that appeal. A ruling on this appeal is not expected until the third quarter of 2007. In the meantime, there has been no ruling on the merits of either the plaintiff s individual claims or the claims of the putative class, and we intend to continue to vigorously defend this matter. The ultimate outcome of this matter and the amount of liability, if any, which may result, is not presently determinable, and legal counsel cannot express an opinion as to the extent of the Company s possible loss, if any, in the lawsuit. If, however, the class certification stands and either or both subclasses were to prevail on the merits, the potential liability could have a material adverse effect on the Company s financial position and results of operations.

In January 2004, we were 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 Accredited, and the complaint alleges that we 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. We were served with eleven substantially similar complaints on behalf of certain other former and current employees, which have been consolidated with the Yturralde action in May 2007. 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 Accredited employees which the court has certified for settlement purposes. The amount payable by us under the settlement is approximately $1.8 million, which was included in accrued expenses.

In December 2002, we were 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 we do business and the common law of unjust enrichment. The complaint alleges that we have a practice of misrepresenting and inflating the amount of fees we pay to third parties in connection with the residential mortgage loans that we fund. The plaintiffs claim to represent a nationwide class consisting of others similarly situated, that is, those who paid us to pay, or reimburse our 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 us for third-party fees in connection with residential mortgage loans and never received a refund of the difference between the amount they paid to us and the amount we 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 us for third-party fees in connection with residential mortgage loans and never received a refund of the difference between the amount they paid us and the amount we 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 we intend 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 extend 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.

We have 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 our business involves the collection of numerous accounts, the validity of liens and compliance with various state and federal lending laws, we are 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. We are also subject to legal proceedings in the ordinary course of business related to employment matters. We do not believe that the resolution of these lawsuits will have a material adverse effect on our financial condition or results of operations.

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

No matters were submitted to a vote of security holders during the quarter ended December 31, 2006.

PART II

ITEM 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities
Market Information and Holders

Our common stock began trading on the NASDAQ Global Select Market® under the symbol LEND on February 14, 2003. The following table provides the high and low sales prices of our common stock for the period indicated, as reported by NASDAQ.

	High	Low
Year ended December 31, 2006		
Fourth quarter	$ 36.95	$ 26.45
Third quarter	$ 48.62	$ 30.48
Second quarter	$ 60.13	$ 43.25
First quarter	$ 54.94	$ 45.51
Year ended December 31, 2005		
Fourth quarter	$ 51.70	$ 31.36
Third quarter	$ 49.27	$ 34.31
Second quarter	$ 46.00	$ 34.29
First quarter	$ 50.75	$ 33.60

As of June 30, 2007, there were 367 holders of record of our common stock. On June 30, 2007, the last sale price reported on the NASDAQ Global Select Market for our common stock was $13.67 per share.

Comparison of Stockholder Return

Set forth below is a line graph comparing the annual percentage change in the cumulative total return on our common stock with the cumulative total returns of the CRSP Total Return Index for the NASDAQ Stock Market and the NASDAQ Total Return Index for Mortgage Bankers and Brokers (SIC 6160-6169) for the period commencing on February 14, 2003 (the date of our initial public offering) and ending on December 31, 2006.

Comparison of Cumulative Total Return from February 14, 2003 through December 31, 2006(1)

of the Company, CRSP Total Return Index for the NASDAQ Stock Market

and NASDAQ total Return Index for Mortgage Bankers and Brokers (SIC 6160-6169)

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(1) Assumes that $100 was invested on February 14, 2003 at the closing price on the date of our initial public offering, in our common stock and each index, and that all dividends have been reinvested. No dividends have been declared on our common stock. Stockholder returns over the indicated period should not be considered indicative of future stockholder returns.

Based on the last sale price reported June 29, 2007 on the NASDAQ Global Select Market for the Company s common stock of $13.67 per share, an investment in our common stock of $100 made on February 14, 2003 would have had a value of $188.55 on June 29, 2007.

Dividends

We have not declared or paid cash dividends on our common stock for the three years ended December 31, 2006, 2005 or 2004. Any determination to pay dividends in the future will be at the discretion of our Board of Directors and will depend upon our results of operations, financial condition, tax laws, and other factors as the Board of Directors, in its discretion, deems relevant.

During 2004, the REIT sold an aggregate of 4,093,678 shares of its 9.75% Series A Perpetual Cumulative Preferred Shares in public offerings registered under the Securities Act of 1933. The REIT declared and paid third and fourth quarter cash dividends in 2004 of $0.3317 per share and $0.609375 per share, respectively, on its 9.75% Series A Perpetual Cumulative Preferred Shares.

During 2005, the REIT declared and paid first, second, third and fourth quarter cash dividends of $0.609375 per share on its 9.75% Series A Perpetual Cumulative Preferred Shares.

During 2006, the REIT declared and paid first, second, third and fourth quarter cash dividends of $0.609375 per share on its 9.75% Series A Perpetual Cumulative Preferred Shares. The fourth quarter dividend was paid on January 2, 2007.

Employee Stock Options

Our stock option plans are part of a broad-based, long-term retention program that is intended to attract and retain talented employees and directors and align stockholder and employee interests.

Pursuant to our 2002 Plan, we may grant options to selected employees, directors and consultants to purchase shares of our common stock at a price not less than the fair market value of the stock at the date of grant. The 2002 Plan provides for the grant of both incentive stock options and non-qualified stock options. Generally, options outstanding vest over periods not exceeding four years and are exercisable for up to ten years from the grant date. The Board of Directors may terminate the 2002 Plan at any time though it must nevertheless honor any stock options previously granted pursuant to the plan.

Additional information regarding our stock option plans and plan activity for 2006, 2005 and 2004 is provided in Item 12 and in our consolidated financial statements. (See Notes to Consolidated Financial Statements, Note 14 Employee Stock and Benefit Plans.)

Stock Repurchase Program

On September 14, 2006, the Board of Directors authorized Accredited to repurchase up to 5 million shares of the Company s stock from time to time through October 1, 2007. Under the program adopted by the Board, shares of Accredited s common stock may be repurchased from time to time in both privately negotiated and open market transactions, including pursuant to a 10b5-1 plan, subject to management s evaluation of market conditions, applicable legal requirements and other factors. A 10b5-1 plan allows Accredited to repurchase shares at times when it would ordinarily not be in the market because of its trading policies and pending developments. The repurchases may be commenced or suspended at any time without prior notice and without further announcement. As of December 31, 2006, Accredited had repurchased and retained 1,000,000 shares. No shares have been purchased under the stock repurchase program since January 1, 2007.

ISSUER PURCHASES OF EQUITY SECURITIES

Period	(a) Total Number of Shares (or Units) Purchased	(b) Average Price Paid per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs
October 1 October 31, 2006	679,400	$ 31.05	679,400	4,320,600
November 1 November 30, 2006	320,600	$ 30.13	320,600	4,000,000
December 1 December 31, 2006				
Total	1,000,000	$ 30.75	1,000,000	4,000,000

ITEM 6. Selected Financial Data

The following selected operating and balance sheet data for the years ended December 31, 2006, 2005 and 2004 and as of December 31, 2006 and 2005 have been derived from our audited consolidated financial statements, included elsewhere in this report. The selected operating and balance sheet data for the years ended December 31, 2003 and 2002 and as of December 31, 2004, 2003 and 2002 have been derived from our audited consolidated financial statements, not included in this report.

You should read the information below along with other financial information and analysis presented in this report, including the section entitled ITEM 7. Management s Discussion and Analysis of Financial Condition and Results of Operations, and our consolidated financial statements and the related notes included elsewhere in this report.

	2006	2005	2004	2003	2002
		(dollars in thousands, except per share amounts)			
Statement of Operations data:					
Interest income	$ 840,071	$ 610,107	$ 357,081	$ 178,982	$ 67,861
Interest expense	$ 553,932	$ 309,953	$ 134,211	$ 63,562	$ 27,891
Provision for losses	$ 77,296	$ 62,892	$ 47,985	$ 17,165	$ 9,488
Net interest income after provision	$ 208,843	$ 237,262	$ 174,885	$ 98,255	$ 30,482
Gain on sale of mortgage loans	$ 202,028	$ 313,105	$ 283,580	$ 225,151	$ 114,696
Total net revenues	$ 440,984	$ 568,573	$ 469,603	$ 338,531	$ 155,219
Total expenses(14)	$ 511,006	$ 301,177	$ 249,880	$ 171,969	$ 107,224
Net income(loss)(14)	$ (205,648)	$ 155,432	$ 130,778	$ 100,015	$ 28,797
Basic earnings(loss) per share(1)	$ (9.09)	$ 7.37	$ 6.42	$ 5.61	$ 4.99
Diluted earnings(loss) per share(1)	$ (9.09)	$ 7.07	$ 6.07	$ 4.97	$ 1.98
Balance Sheet data:(2)					
Mortgage loans held for sale, net(3)	$ 2,073,268	$ 2,252,252	$ 1,790,134	$ 1,279,590	$ 972,349
Mortgage loans held for investment, net(4)	$ 8,478,682				