

Accredited Mortgage Loan REIT Trust  
Form 10-Q  
May 10, 2006  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

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(Mark One)

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

For the quarterly period ended March 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 001-32276

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**ACCREDITED MORTGAGE LOAN REIT TRUST**

(Exact name of registrant as specified in its charter)

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Maryland  
(State or other jurisdiction of  
incorporation or organization)

15090 Avenue of Science

35-2231035  
(I.R.S. Employer  
Identification No.)

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San Diego, California 92128

(Address of principal executive offices) (Zip Code)

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

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

<b>Title of each class</b>	<b>Name of each exchange on which registered</b>
9.75% Series A Perpetual Cumulative Preferred Shares	New York Stock Exchange (the NYSE )

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

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

The number of outstanding shares of the registrant's common stock as of May 5, 2006 was 100,000.

(1) See explanatory note.

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**EXPLANATORY NOTE**

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

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**FORWARD-LOOKING STATEMENTS**

This report contains certain forward-looking statements. When used in this report, statements which are not historical in nature, including the words anticipate, estimate, should, expect, believe, intend and similar expressions are intended to identify forward-looking statements. This report includes statements containing a projection of revenues, earnings or losses, capital expenditures, dividends, capital structure or other financial terms.

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

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

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

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

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

our ability to maintain status as a real estate investment trust and the corresponding tax treatment;

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

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

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

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

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

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



**Table of Contents****PART I****ITEM 1. Financial Statements****ACCREDITED MORTGAGE LOAN REIT TRUST****BALANCE SHEETS****(Dollars in thousands, except par value)**

	<b>March 31, 2006 (Unaudited)</b>	<b>December 31, 2005</b>
<b>ASSETS</b>		
Cash and cash equivalents	\$ 3,708	\$ 6,158
Accrued interest receivable	36,536	32,604
Mortgage loans held for investment, net of allowance of \$108,375 and \$98,399, respectively	6,700,673	6,240,136
Derivative assets, including margin account	86,958	65,347
Prepaid expenses and other assets	34,822	30,322
Receivable from parent	137,097	99,642
Total assets	\$ 6,999,794	\$ 6,474,209
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>LIABILITIES:</b>		
Credit facilities	\$ 16,367	\$ 15,640
Securitization bond financing	6,637,982	6,169,886
Accrued interest payable	9,466	5,115
Total liabilities	6,663,815	6,190,641
<b>STOCKHOLDERS EQUITY:</b>		
Preferred stock, \$1.00 par value; authorized 20,000,000 shares; 4,093,678 shares designated, issued and outstanding as 9.75% Series A Perpetual Cumulative Preferred Shares with an aggregate liquidation preference of \$102,342 at March 31 2006 and December 31,2005	4,094	4,094
Common stock, \$.001 par value; authorized 100,000,000 shares; issued and outstanding 100,000 at March 31, 2006 and December 31,2005	1	1
Additional paid-in capital	311,774	303,180
Accumulated other comprehensive income	41,850	23,991
Accumulated deficit	(21,740)	(47,698)
Total stockholders equity	335,979	283,568
Total liabilities and stockholders equity	\$ 6,999,794	\$ 6,474,209

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



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

	<b>Three Months Ended March 31,</b>	
	<b>2006</b>	<b>2005</b>
<b>REVENUES:</b>		
Interest income (including \$1,588 and \$207 from parent)	\$ 125,719	\$ 84,097
Interest expense	(71,476)	(34,526)
Net interest income	54,243	49,571
Provision for losses on loans held for investment	(6,370)	(2,802)
Net interest income after provision	47,873	46,769
Other income	688	92
Total net revenues	48,561	46,861
<b>OPERATING EXPENSES:</b>		
Management fee assessed by parent	7,800	5,346
Direct general and administrative expenses	9	59
Total operating expenses	7,809	5,405
Net income	40,752	41,456
Dividends on preferred stock	(2,495)	(2,495)
Net income available to common stockholders	\$ 38,257	\$ 38,961
Basic and diluted earnings per common share	\$ 382.57	\$ 389.61
Weighted average shares outstanding for basic and diluted	100	100

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

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

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2006</b>	<b>2005</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 40,752	\$ 41,456
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of net deferred origination fees on securitized loans	(967)	(621)
Amortization of deferred costs	3,365	313
Provision for losses on loans held for investment	6,370	2,802
Unrealized loss on derivatives	5,210	7,129
Adjustment into earnings for gain on derivatives from other comprehensive income	(6,887)	(2,296)
Changes in operating assets and liabilities:		
Accrued interest receivable	(3,932)	(3,557)
Derivative assets, including margin account	(2,748)	(12,136)
Prepaid expenses and other assets	(3,112)	20,447
Accrued interest payable	4,351	335
Net cash provided by operating activities	42,402	53,872
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Principal payments received on mortgage loans held for investment	510,805	349,927
Net cash provided by investing activities	510,805	349,927
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from issuance of securitization bond financing, net of fees	995,325	899,374
Payments on securitization bond financing	(529,853)	(351,901)
Payments on temporary credit facilities	(977,267)	(917,632)
Capital contributions from parent	8,388	3,000
Net (increase) decrease in receivable from parent	(37,455)	4,598
Payments of common stock dividends	(12,300)	(5,000)
Payments of preferred stock dividends	(2,495)	(2,495)
Net cash used in financing activities	(555,657)	(370,056)
Net (decrease) increase in cash and cash equivalents	(2,450)	33,743
Beginning balance cash and cash equivalents	6,158	4,018
Ending balance cash and cash equivalents	\$ 3,708	\$ 37,761

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

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**ACCREDITED MORTGAGE LOAN REIT TRUST**

**NOTES TO FINANCIAL STATEMENTS**

**For the Three Months Ended March 31, 2006 and 2005**

**1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Basis of Presentation**

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

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

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

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

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

**Use of Estimates**

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

**Cash and Cash Equivalents**

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

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**ACCREDITED MORTGAGE LOAN REIT TRUST**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

**For the Three Months Ended March 31, 2006 and 2005**

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

Typically each quarter, the Loans Held for Securitization, which are originated by and to this point have been held in AHL, are contributed at the current carrying amount to the REIT. The carrying amount transferred to the REIT consists of the unpaid principal balance, the net deferred origination fees, the basis adjustment for fair value hedge accounting (from funding to contribution date) and the allowance for loan losses. The loans remain in the Loans Held for Securitization for approximately 10 business days prior to the close of the securitization transaction and are thereafter designated as Loans Held for Investment.

Mortgage loans held for investment represent loans that the REIT has securitized in structures that require financing treatment. During the three months ended March 31, 2006, the REIT completed one securitization of mortgage loans totaling \$1.0 billion structured as financings under SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities a replacement of FASB Statement No. 125*.

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

The REIT periodically evaluates the need for or the adequacy of the allowance for loan losses on its mortgage loans held for investment. Provision for loan losses on mortgage loans held for investment is made in an amount sufficient to maintain credit loss allowances at a level considered appropriate to cover probable losses in the portfolio. The REIT defines a loan as non-accruing at the time the loan becomes 90 days or more delinquent under its payment terms. Probable losses are determined based on segmenting the portfolio relating to their contractual delinquency status and applying the REIT's and AHL's historical loss experience. The REIT also uses other analytical tools to determine the reasonableness of the allowance for loan losses. Loss estimates are reviewed periodically and adjustments are reported in earnings. As these estimates are influenced by factors outside of the REIT's control, there is uncertainty inherent in these estimates, making it reasonably possible that they could change. Loans foreclosed upon or deemed uncollectible are carried at estimated net realizable value.

**Derivative Financial Instruments**

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

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**ACCREDITED MORTGAGE LOAN REIT TRUST**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

**For the Three Months Ended March 31, 2006 and 2005**

*Fair Value Hedges*

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

*Cash Flow Hedges*

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

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

**Loan Origination Costs and Fees**

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

**Interest Income**

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

**Income Taxes**

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

**Table of Contents****ACCREDITED MORTGAGE LOAN REIT TRUST****NOTES TO FINANCIAL STATEMENTS (Continued)****For the Three Months Ended March 31, 2006 and 2005****Real Estate Owned**

Real estate acquired in settlement of loans generally results when property collateralizing a loan is foreclosed upon or otherwise acquired by AHL, as our servicer, in satisfaction of the loan. Real estate acquired through foreclosure is carried at fair value less estimated costs to dispose. Fair value is based on the net amount that the REIT could reasonably expect to receive for the asset in a current sale between a willing buyer and a willing seller, that is, other than in a forced or liquidation sale. Adjustments to the carrying value of real estate owned are made through valuation allowances and charge-offs recognized through a charge to earnings. Legal fees and other direct costs incurred after foreclosure are expensed as incurred. At March 31, 2006 and December 31, 2005, real estate owned amounting to \$14.5 million and \$10.5 million, respectively, net of valuation allowances, is included in other assets.

**Other Comprehensive Income**

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

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

	<b>2006</b>	<b>2005</b>
	<b>(In thousands)</b>	<b>(Unaudited)</b>
Net income	\$ 40,752	\$ 41,456
Net unrealized gains on cash flow hedges	24,746	23,966
Reclassification adjustment into earnings for realized gain on derivatives	(6,887)	(2,296)
Total comprehensive income	\$ 58,611	\$ 63,126

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

Properties securing mortgage loans held for investment are geographically dispersed throughout the United States. At March 31, 2006, 22% and 11% of the unpaid principal balance of mortgage loans held for investment were secured by properties located in California and Florida, respectively. At December 31, 2005, 23% and 11% of the unpaid principal balance of mortgage loans held for investment were secured by properties located in California and Florida, respectively. The remaining properties securing mortgage loans did not exceed 10% in any other state at March 31, 2006 and December 31, 2005.

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

**Table of Contents****ACCREDITED MORTGAGE LOAN REIT TRUST****NOTES TO FINANCIAL STATEMENTS (Continued)****For the Three Months Ended March 31, 2006 and 2005****3. MORTGAGE LOANS HELD FOR INVESTMENT**

Mortgage loans held for investment were as follows:

	March 31, 2006	December 31, 2005
	(In thousands)	
	(Unaudited)	
Principal balance	\$ 6,828,473	\$ 6,350,870
Basis adjustment for fair value hedge accounting	(6,780)	(4,766)
Net deferred origination fees	(12,645)	(7,569)
Allowance for loan losses	(108,375)	(98,399)
Loans held for investment, net	\$ 6,700,673	\$ 6,240,136

*Allowance for losses* Activity in the allowance was as follows:

	Balance at Beginning of Period	Contributions from Parent	Provision for Losses	Chargeoffs, net	Balance at End of Period
	(In thousands) (Unaudited)				
<b>Three Months Ended March 31,:</b>					
<b>2006:</b>					
Mortgage loans held for investment	\$ 98,399	\$ 8,431	\$ 1,774	\$ (229)	\$ 108,375
Real estate owned	6,996		4,596	(1,906)	9,686
Total	\$ 105,395	\$ 8,431	\$ 6,370	\$ (2,135)	\$ 118,061
<b>2005:</b>					
Mortgage loans held for investment	\$ 54,960	\$ 7,622	\$ 1,244	\$ (3)	\$ 63,823
Real estate owned	2,028		1,558	(922)	2,664
Total	\$ 56,988	\$ 7,622	\$ 2,802	\$ (925)	\$ 66,487

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

At March 31, 2006		At December 31, 2005	
Total Principal Amount	Delinquent Principal Over 90 Days	Total Principal Amount	Delinquent Principal Over 90 Days

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	(In thousands)			
	(Unaudited)			
Mortgage loans held for investment	\$ 6,828,473	\$ 83,510(1)	\$ 6,350,870	\$ 70,990(1)
Real estate owned	24,215	24,215	17,490	17,490
<b>Total</b>	<b>\$ 6,852,688</b>	<b>\$ 107,725</b>	<b>\$ 6,368,360</b>	<b>\$ 88,480</b>

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(1) For loans 90 days or more delinquent we cease to accrue interest income and reverse all previously accrued but uncollected income.



**Table of Contents****ACCREDITED MORTGAGE LOAN REIT TRUST****NOTES TO FINANCIAL STATEMENTS (Continued)****For the Three Months Ended March 31, 2006 and 2005****4. DERIVATIVE FINANCIAL INSTRUMENTS*****Fair Value Hedges***

The REIT uses hedge accounting as defined by SFAS No. 133 for certain derivative financial instruments used to hedge its loans held for investment. At March 31, 2006 and December 31, 2005, fair value hedge basis adjustments of (\$6.8 million) and (\$4.8 million) are included as additions to loans held for investment. No hedge ineffectiveness associated with fair value hedges was recorded in earnings during the three months ended March 31, 2006 or 2005, as the REIT has discontinued fair value hedge accounting on loans held for investment.

***Cash Flow Hedges***

The REIT utilizes cash flow hedging and cash flow hedge accounting on its securitization debt under SFAS No. 133. Effective unrealized gains, net of effective unrealized losses, associated with cash flow hedges of \$24.7 million were recorded in other comprehensive income during the three months ended March 31, 2006, which is reported as a component of stockholders' equity. These contracts settle on various dates ranging from June 2006 to June 2015. A total of \$27.9 million in net effective gains, included in other comprehensive income at March 31, 2006, is expected to be recognized in earnings during the next twelve months. Hedge ineffectiveness associated with cash flow hedges of \$0.5 million and \$1.1 million was recorded in earnings during the three months ended March 31, 2006 and 2005, respectively, and are included as a component of interest expense in the statements of operations.

***Futures Contracts, Options Contracts, Interest Rate Swap and Cap Agreements and Margin Accounts***

At March 31, 2006 the REIT had outstanding Eurodollar futures contracts, options contracts and interest rate swap agreements that were designated as hedge instruments, as well as interest rate cap agreements. The fair value of the options contracts, interest rate swap and cap agreements, and the fair value of the margin account balances required for these derivatives and the futures contracts were as follows:

	<b>March 31, 2006</b>	<b>December 31, 2005</b>
	<b>(In thousands)</b>	
	<b>(Unaudited)</b>	
Options contracts	\$ 6,844	\$ 4,739
Interest rate swap agreements	12,543	12,113
Interest rate cap agreements	30	53
	19,417	16,905
Margin account balances	67,541	48,442
Derivative assets, including margin account	\$ 86,958	\$ 65,347

**Table of Contents****ACCREDITED MORTGAGE LOAN REIT TRUST****NOTES TO FINANCIAL STATEMENTS (Continued)****For the Three Months Ended March 31, 2006 and 2005**

A gain of \$2 thousand and \$1.7 million on derivative instruments not designated for SFAS No. 133 hedge accounting treatment was recorded in interest expense on the statement of operations during the three months ended March 31, 2006 and 2005, respectively, relating to the gain in value of interest rate cap agreements and interest rate swap agreements. The change in fair value of derivative financial instruments, and the related hedged liability, recorded in the statement of operations was as follows:

	<b>Interest Income</b>	<b>Interest Expense</b>	<b>Total</b>
	<b>(In thousands) (Unaudited)</b>		
<b>Three Months Ended March 31,:</b>			
<b>2006:</b>			
Net unrealized gain (loss)	\$ 673	\$ (5,883)	\$ (5,210)
Net realized gain (loss)		13,278	13,278
<b>Total</b>	<b>\$ 673</b>	<b>\$ 7,395</b>	<b>\$ 8,068</b>
<b>2005:</b>			
Net unrealized gain (loss)	\$ (1,778)	\$ (5,351)	\$ (7,129)
Net realized gain (loss)		10,215	10,215
<b>Total</b>	<b>\$ (1,778)</b>	<b>\$ 4,864</b>	<b>\$ 3,086</b>

**5. CREDIT FACILITIES**

In connection with the REIT's execution of securitization transactions through the first quarter of 2005, AHL and the REIT, as several borrowers or sellers, entered into warehouse transactions with lenders to finance the related mortgage loans that were contributed by AHL to the REIT and then subsequently securitized with permanent bond financing. The net proceeds of the securitizations are to be used by AHL or the REIT to repay the warehouse debt and pay other expenses of the securitization.

AHL and the REIT, as several sellers, have entered into temporary aggregate warehouse facilities to permit the securitization of mortgage loans. The duration of any one of these facilities is approximately 30 days. Each of the agreements has cross-default and cross-collateralization provisions and AHL provides a guarantee of the REIT's obligations under the facilities; in addition, the facilities are structured so that the REIT only has monetary responsibilities for a limited period of time prior to a securitization and otherwise does not have any monetary obligations under the facilities ( REIT Transaction ).

Beginning in the second quarter of 2005, AHL and the REIT secured modifications to the existing AHL warehouse credit facilities agreements providing for the financing of assets held for securitization. These modified agreements allow for the financing of loans for an approximate 30 day period prior to the close of the securitization transaction.

Prior to the date of contribution of the mortgage loan assets scheduled for securitization, AHL is the primary obligor. Subsequent to the contribution date the REIT becomes the primary obligor. AHL provides a guarantee of the REIT's obligations under the modified warehouse credit facilities.

The facilities are collateralized by performing, aged and delinquent loans, and mortgage backed securities that bear interest at One-Month LIBOR plus a spread. Amounts outstanding on these warehouse facilities were \$16.4 million and \$15.6 million at March 31, 2006 and December 31, 2005, respectively.



**Table of Contents****ACCREDITED MORTGAGE LOAN REIT TRUST****NOTES TO FINANCIAL STATEMENTS (Continued)****For the Three Months Ended March 31, 2006 and 2005****6. SECURITIZATION BOND FINANCING**

Securitization bond financing consisted of the following:

	Balance		Interest Rate Range		Final Stated Maturity
	3/31/2006 (Unaudited)	12/31/2005	Fixed	Variable (LIBOR+)	
2002 two securitizations	\$ 108,027	\$ 136,634	4.48% - 4.93%	.32% - .50%	2033
2003 three securitizations	357,931	406,650	3.58% - 4.46%	.35% - .38%	2034
2004 four securitizations	1,697,489	1,882,537	2.90% - 5.25%	.15% - 2.50%	2035
2005 four securitizations	3,490,147	3,747,597	N/A	.08% - 2.50%	2035
2006 one securitization	987,697		N/A	.06% - 2.10%	2036
	6,641,291	6,173,418			
Unamortized bond discounts	(3,309)	(3,532)			
Total securitization bond financing, net	\$ 6,637,982	\$ 6,169,886			

The bonds are collateralized by loans held for investment with an aggregate outstanding principal balance of \$6.8 billion and \$6.4 billion as of March 31, 2006 and December 31, 2005, respectively. Unamortized debt issuance costs, included in prepaid expenses and other assets, are \$20.3 million and \$19.7 million at March 31, 2006 and December 31, 2005, respectively.

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

The securitization agreements require that a certain level of overcollateralization be maintained for the bonds. A portion of the excess interest may be initially distributed as principal to the bondholders to increase the level of overcollateralization. Once a certain level of overcollateralization has been reached, excess interest is no longer distributed as principal to the bondholders, but, rather, is passed through to the REIT. Should the level of overcollateralization fall below a required level, excess interest will again be paid as principal to the bondholders until the required level has been reached.

The securitization agreements provide that if delinquencies or losses on the underlying mortgage loans exceed certain maximums, the required levels of credit enhancement would be increased.

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

**Table of Contents****ACCREDITED MORTGAGE LOAN REIT TRUST****NOTES TO FINANCIAL STATEMENTS (Continued)****For the Three Months Ended March 31, 2006 and 2005**

The following table summarizes the expected repayments relating to the securitization bond financing at March 31, 2006. Amounts listed as bond payments are based on anticipated receipts of principal and interest on underlying mortgage loan collateral using historical prepayment spreads:

	(In thousands)
	(Unaudited)
Nine months ending December 31, 2006	\$ 1,862,987
<b>Year Ending December 31:</b>	
2007	1,934,974
2008	998,269
2009	561,293
2010	385,980
2011	256,677
Thereafter	641,111
Discount	(3,309)
Total	\$ 6,637,982

**7. INCOME TAXES AND DISTRIBUTION OF EARNINGS**

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

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

	Three Months Ended March 31, 2006 (In thousands)	Three Months Ended March 31, 2005 (Unaudited)
Federal income tax at statutory rate	\$ 14,263	\$ 14,509
Preferred stock dividends at statutory rate	(873)	(873)
Common stock dividends paid deduction and other	(13,390)	(13,636)
Total provision	\$	\$

**8. PREFERRED STOCK**

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

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**ACCREDITED MORTGAGE LOAN REIT TRUST**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

**For the Three Months Ended March 31, 2006 and 2005**

*9.75% Series A Perpetual Cumulative Preferred Shares*

The Board of Trustees and a duly authorized committee thereof has classified and designated 4,093,678 preferred shares as Series A Preferred Shares. At March 31, 2006 and December 31, 2005, there were 4,093,678 preferred shares issued and outstanding.

On March 1, 2006, the REIT's board of trustees declared a quarterly cash dividend on the Preferred Shares at the rate of \$0.609375 per share to shareholders of record on March 15, which aggregated \$2.5 million for the three months ended March 31, 2006.

The Series A Preferred Shares contain covenants requiring the REIT to maintain a total shareholders' equity balance and total loans held for investment of at least \$50.0 million and \$2.0 billion, respectively, commencing on December 31, 2004 and at the end of each quarter thereafter. In addition, commencing with each of the four quarters ending December 31, 2005, the REIT is also required to maintain cumulative unencumbered cash flow (as defined in the agreement) greater than or equal to six times the cumulative preferred dividends required in those four quarters. If the REIT is not in compliance with any of these covenants, no dividends can be declared on the REIT's common shares until it is in compliance with all covenants as of the end of two successive quarters. As of March 31, 2006, the REIT was in compliance with the covenants applicable to date in 2006.

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

**9. RECEIVABLE FROM PARENT AND ADMINISTRATION AND SERVICING AGREEMENT WITH PARENT**

The REIT has an administration and servicing agreement with its parent company, AHL, whereby AHL provides loan servicing, treasury, accounting, tax and other administrative services for the REIT in exchange for a management fee equal to 0.5% per year on the outstanding principal balance of the loans serviced, plus miscellaneous fee income collected from mortgagors including late payment charges, assumption fees and similar items. Under this agreement, either party agrees to pay interest on the net average balance payable to the other party at an annual rate equal to the Six-Month LIBOR plus 1.0%. Management fee expense under this agreement totaled \$7.8 million and \$5.3 million for the three months ended March 31, 2006 and 2005, respectively. Interest income under this agreement totaled \$1.6 million and \$0.2 million for the three months ended March 31, 2006 and 2005, respectively. At March 31, 2006 and December 31, 2005, the net receivable from parent was \$137.1 million and \$99.6 million, respectively. It is Accredited's practice to periodically paydown intercompany balances.

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**ACCREDITED MORTGAGE LOAN REIT TRUST**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

**For the Three Months Ended March 31, 2006 and 2005**

**10. SUPPLEMENTAL CASH FLOW INFORMATION**

The following represents supplemental cash flow information:

	<b>Three Months Ended March 31,</b>	
	<b>2006</b>	<b>2005</b>
	<b>(In thousands) (Unaudited)</b>	
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</b>		
Cash paid during the year for interest	\$ 61,147	\$ 38,970
<b>SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:</b>		
Transfer of loans held for investment to real estate owned, net of reserves, included in other assets	\$ 6,725	\$ 1,479
<b>Detail of assets and liabilities contributed from parent:</b>		
Cash contributions	\$ 8,388	\$ 3,000
Mortgage loans, net of reserves	986,931	909,607
Other net assets (liabilities)	(8,730)	(5,313)
Outstanding balances on warehouse credit facilities	(977,995)	(917,632)
Net capital contributions from parent	\$ 8,594	\$ (10,338)



## **Table of Contents**

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

The following discussion should be reviewed in conjunction with our financial statements and the related notes and other financial information appearing elsewhere in this report. In addition to historical information, the following discussion and other parts of this document contain forward-looking information that involves risks and uncertainties. Please refer to the section entitled "Forward-Looking Statements" on page 5 of this Form 10-Q. Our actual results could differ materially from those anticipated by such forward-looking information due to factors discussed under the section below entitled "Risk Factors" and elsewhere in this report.

#### **General**

Accredited Mortgage Loan REIT Trust (the "REIT") was formed on May 4, 2004 as a Maryland real estate investment trust for the purpose of acquiring, holding and managing real estate assets. All of our outstanding common shares are held by Accredited Home Lenders, Inc. ("AHL"), a wholly-owned subsidiary of Accredited Home Lenders Holding Co ("Accredited").

Our intention is to hold all securitized loans and related securitization bond financing activities of AHL. We acquire mortgage assets and assume related funding obligations from AHL, who also provides operating facilities, administration and servicing for us. We are, therefore, economically and operationally dependent on AHL, and, as such, our results of operation or financial condition may not be indicative of the conditions that would have existed for our results of operations or financial condition if we had operated as an unaffiliated entity.

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

Our operations generate revenues from interest income over the life of the loans that we have securitized in structures that require financing treatment for accounting purposes. This interest is partially offset by the interest we pay on the bonds that we issue to repay warehouse debt incurred to fund these loans, the fees and expenses of securitization participants, such as the servicer and the trustees, as well as our provision for losses on the loans. The provision for loan losses is generally determined as the amount sufficient to maintain credit loss reserves at a level considered by us to be adequate to cover probable losses in the securitized loan portfolio.

Although the securitizations are legally structured as sales for accounting purposes they are treated as financings under Statement of Financial Accounting Standards ("SFAS") No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* a replacement of FASB Statement No. 125. The securitizations do not meet the qualifying special purpose entity criteria under SFAS No. 140 and related interpretations because after the mortgage loans are securitized, the securitization trust may acquire derivatives relating to beneficial interests retained by us. Also, AHL, as servicer, subject to applicable contractual provisions, has sole discretion to use its best commercial judgment in determining whether to sell or work out any mortgage loans securitized through the securitization trust that become troubled. Accordingly, the mortgage loans and securitization indebtedness are included in our balance sheet. We record interest income on the mortgage loans and interest expense on the securities issued from the securitization over the life of the securitization. Our profitability in large part depends on the difference, or spread, between these amounts.

We expect our mortgage loan portfolio to grow based on the trend of receiving capital contributions of assets and liabilities from AHL for our quarterly securitizations. To the extent that the contributions of mortgage loans for securitizations by AHL are greater than the rate of payments received on existing securitized mortgage loans, we would expect growth in our total mortgage loan portfolio.

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We anticipate that our results of operations will fluctuate on a quarterly and annual basis. The timing and degree of fluctuation will depend upon several factors, including competition, economic slowdowns and increased interest rates in addition to those discussed under Risk Factors . We cannot assure you that we will be able to sustain revenue growth or maintain profitability on a quarterly or annual basis or that our growth will be consistent with predictions made, if any, by securities analysts.

**Results Of Operations***Three Months Ended March 31, 2006 Compared to the Three Months Ended March 31, 2005**Net Revenues*

Net revenues and key indicators that affected our net revenues were as follows:

	Three Months Ended	Three Months Ended	Increase (Decrease)	% Change
	March 31, 2006	March 31, 2005 (Dollars in thousands)		
Interest income	\$ 125,719	\$ 84,097	\$ 41,622	49.5%
Interest expense	(71,476)	(34,526)	(36,950)	107.0%
Net interest income	54,243	49,571	4,672	9.4%
Provision for losses	(6,370)	(2,802)	(3,568)	127.3%
Net interest income after provision	47,873	46,769	1,104	2.4%
Other income	688	92	596	647.8%
Total net revenues	\$ 48,561	\$ 46,861	\$ 1,700	3.6%
Average inventory of loans held for investment	\$ 6,473,292	\$ 4,466,039	\$ 2,007,253	45.0%
Annualized interest income as a percentage of average inventory of loans held for investment	7.77%	7.53%		

**Interest Income and Expense.** Interest income totaled \$125.7 million (including interest from the parent of \$1.6 million) for the three months ended March 31, 2006, and \$84.1 million (including interest from the parent of \$0.2 million) for the comparable period in 2005, and was generated primarily from our loans held for investment. Interest income also includes prepayment penalties, the realized and unrealized gains and losses on derivatives purchased to manage our interest rate risk on our interest bearing assets, changes in the related fair value of the derivatives and intercompany interest income.

Interest expense totaled \$71.5 million for the three months ended March 31, 2006, and \$34.5 million for the comparable period in 2005, and represents interest incurred on our securitization bond financings and our interim warehouse credit facilities, amortization of bond issue costs and realized and unrealized gains and losses on derivatives purchased to manage our interest rate risk on our interest bearing liabilities.

The net interest spread for our securitized loans declined from 4.32% during the three months ended March 31, 2005 to 3.32% for the three months ended March 31, 2006. The decline reflects higher cost of borrowings due to market interest rates increasing, partially offset by increases in coupon rate.

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The components of our net interest margin are as follows:

	Three Months Ended			Three Months Ended		
	Interest Income (Expense)	March 31, 2006 Average Balance Outstanding	Average Rate  (Dollars in thousands)	Interest Income (Expense)	March 31, 2005 Average Balance Outstanding	Average Rate
Interest income	\$ 113,010	\$ 6,473,292	6.98%	\$ 76,321	\$ 4,466,039	6.84%
Other income	12,710		0.79%	7,775		0.70%
Interest expense	(75,728)	6,433,381	(4.71)%	(36,593)	4,303,908	(3.40)%
Other expense	4,251		0.26%	2,068		0.18%
Spread	\$ 54,243		3.32%	\$ 49,571		4.32%
Net interest margin	\$ 54,243	\$ 6,473,292	3.35%	\$ 49,571	\$ 4,466,039	4.44%

The net interest spread for our securitized loans declined from 4.32% during the three months ended March 31, 2005 to 3.32% for the comparable period in 2006. The decline reflects higher cost of borrowings due to market interest rates increasing, partially offset by increases in coupon rate. Other interest income consists primarily of prepayment penalties and other interest expense is primarily gains from hedging.

**Provision for Losses.** The provision for losses is comprised of the following for the three months ended March 31:

	2006	2005	Increase (Decrease)	% Change
	(dollars in thousands)			
Current period provision for:				
Loans held for investment	\$ 1,774	\$ 1,244	\$ 530	42.6%
Real estate owned	4,596	1,558	3,038	195.0%
Total provision for losses	\$ 6,370	\$ 2,802	\$ 3,568	127.3%
Reserve balance at period end:				
Loans held for investment	\$ 108,375	\$ 63,823	\$ 44,552	69.8%
Principal balance at period end:				
Loans held for investment	\$ 6,828,473	\$ 4,667,616	\$ 2,160,857	46.3%
Reserve balance on loans as a percentage of the principal balance at period end	1.6%	1.4%		

Provision for losses reflects additions to reserves after the loans and related reserves are contributed from AHL to the REIT. The relatively higher reserve balance is the result of those contributions.

The provision for losses related to REO assets increased 195.0% for the three months ended March 31, 2006, as compared to the same period in 2005. This increase is directly related to a corresponding increase in the level of REO assets held at the end of the reporting periods.

The ratio of loss reserve to principle outstanding at March 31, 2006, increased to 1.6% from 1.4% for the same period in 2005. The increase is due primarily to expected losses resulting from an increase in the aging of the portfolio.

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We currently expect our provision for losses to increase in 2006 at a rate similar to the growth rate of our average on-balance sheet loan portfolio.

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**Management Fee Assessed by Parent Company.** The management fee assessed by the parent, AHL, for servicing and general and administrative services totaled \$7.8 million for the three months ended March 31, 2006, and \$5.3 million for the three months ended March 31, 2005, and represents 0.5% per annum on the monthly outstanding principal balance of the loans serviced by AHL, plus miscellaneous fee income collected from mortgagors, including late payment charges, assumption fees and similar items.

**Direct General and Administrative Expense.** Direct general and administrative expenses totaled \$9,000 for the three months ended March 31, 2006 and \$59,000 for the three months ended March 31, 2005 and represent audit, legal and trustee fees incurred directly by the REIT.

**Income taxes.** There is no provision for income taxes for the three months ended March 31, 2006 or for the three months ended March 31, 2005, as we expect to dividend all of our 2006 taxable income to preferred and common shareholders. It is anticipated that, in conjunction with satisfying the ongoing distribution requirements applicable to a real estate investment trust, we will continue to dividend all of our taxable income to shareholders. Therefore, we do not expect to record an income tax provision in 2006. Our parent company, AHL, will be subject to federal and state taxes on the taxable income that is distributed to it at the parent company's effective tax rate.

## **Liquidity and Capital Resources**

### *Parent Contributions*

During the three months ended March 31, 2006, AHL contributed to the REIT mortgage loans, net of reserves, of \$986.9 million, cash of \$8.4 million, and other net liabilities of \$8.7 million, reduced by contributions of aggregate outstanding credit facility balances of \$978.0 million, resulting in contributions to Additional Paid in Capital of \$8.6 million. AHL may from time-to-time in the future contribute additional capital or other net assets to us.

### *Preferred Stock*

On March 1, 2006, the REIT's board of trustees declared a quarterly cash dividend on our Preferred Shares at the rate of \$0.609375 per share to shareholders of record on March 15, which aggregated \$2.5 million for the three months ended March 31, 2006.

The Series A Preferred Shares contain covenants requiring us to maintain a total shareholders' equity balance and total loans held for investment of at least \$50 million and \$2.0 billion, respectively, commencing on December 31, 2004 and at the end of each quarter thereafter, and, commencing with each of the four quarters ending December 31, 2005, to maintain a cumulative unencumbered cash flow greater than or equal to six times the cumulative preferred dividends required in those four quarters. If we are not in compliance with any of these covenants, no dividends can be declared on our common stock until we are in compliance with all covenants as of the end of two successive quarters. As of March 31, 2006, we were in compliance with the covenants applicable to date in 2006.

### *Securitizations*

In March 2006, we completed a securitization containing \$1.0 billion of first and second priority residential mortgage loans through the REIT. The securitization utilized a senior/subordinated structure consisting of senior and subordinated notes with a final stated maturity date in approximately thirty years. The securitization is structured as a financing; therefore, both the mortgage loans and the debt represented by the notes will remain on our consolidated balance sheet. We used the proceeds from this securitization primarily to repay warehouse financing for the mortgage loans.

### *Summary of Cash Activity*

Cash provided by operating activities of \$42.4 million, cash provided by principal payments received on mortgage loans held for investment of \$510.8 million, cash capital contributions from AHL of \$8.4 million and

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net proceeds from the issuance of securitized bond financing of \$995.3 million during the three months ended March 31, 2006 were used primarily to pay off outstanding credit facility balances contributed by AHL of \$977.3 million, to fund payments on the securitization bond financing of \$529.9 million and to pay dividends on our common and preferred stock of \$12.3 million and \$2.5 million, respectively.

### *Credit Facilities*

In connection with the REIT's execution of securitization transactions through the first quarter of 2005, AHL and the REIT, as several borrowers or sellers, entered into warehouse transactions with lenders to finance the related mortgage loans that were contributed by AHL to the REIT and then subsequently securitized with permanent bond financing. The net proceeds of the securitizations are to be used by AHL or the REIT to repay the warehouse debt and pay other expenses of the securitization.

AHL and the REIT, as several sellers, have entered into temporary aggregate warehouse facilities to permit the securitization of mortgage loans. The duration of any one of these facilities is approximately 30 days. Each of the agreements has cross-default and cross-collateralization provisions and AHL provides a guarantee of the REIT's obligations under the facilities; in addition, the facilities are structured so that the REIT only has monetary responsibilities for a limited period of time prior to a securitization and otherwise does not have any monetary obligations under the facilities ( REIT Transaction ).

Beginning in the second quarter of 2005, AHL and the REIT secured modifications to the existing AHL warehouse credit facilities agreements providing for the financing of assets held for securitization. These modified agreements allow for the financing of loans for an approximate 30 day period prior to the close of the securitization transaction.

Prior to the date of contribution of the mortgage loan assets scheduled for securitization, AHL is the primary obligor. Subsequent to the contribution date the REIT becomes the primary obligor. AHL provides a guarantee of the REIT's obligations under the modified warehouse credit facilities.

The facilities are collateralized by performing, aged and delinquent loans, and mortgage backed securities that bear interest at One-Month LIBOR plus a spread. Amounts outstanding on these warehouse facilities were \$16.4 million and \$15.6 million at March 31, 2006 and December 31, 2005, respectively.

### *Parent Guarantee*

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

We anticipate that our liquidity, credit facilities and capital resources will be sufficient to fund our operations for the foreseeable future.

### **Market Risk**

Market risks generally represent the risk of loss that may result from the potential change in the value of a financial instrument due to fluctuations in interest and foreign exchange rates and in equity and commodity prices. Our market risk relates primarily to interest rate fluctuations. We may be directly affected by the level of and fluctuations in interest rates, which affect the spread between the rate of interest received on our mortgage

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loans held for investment and the related financing rate. Our profitability could be adversely affected during any period of unexpected or rapid changes in interest rates, by impacting the value of loans held for investment and changing the level of loan prepayments, thereby adversely affecting our long-term net interest income.

The objective of interest rate risk management is to control the effects that interest rate fluctuations have on the value of our assets and liabilities. Our management of interest rate risk is intended to mitigate the volatility of earnings associated with fluctuations in the net interest on loans held for investment due to changes in the current market rate of interest.

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

### *Derivative Instruments and Hedging Activities*

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

### *Fair Value Hedges*

We designate certain derivative financial instruments as hedge instruments under SFAS No. 133, and, at trade date, these instruments and their hedging relationship are identified, designated and documented. For derivative financial instruments designated as hedge instruments, we evaluate the effectiveness of these hedges against the hedged asset or liability to ensure that there remains adequate correlation in the hedge relationship.

### *Cash Flow Hedges*

During the third quarter of 2004, we began utilizing cash flow hedging and implemented the use of cash flow hedge accounting on our securitization debt under SFAS No. 133. Pursuant to SFAS No. 133 hedge instruments have been designated as hedging the exposure to variability of cash flows from our securitization debt attributable to interest rate risk. Cash flow hedge accounting requires that the effective portion of the gain or loss in the fair value of a derivative instrument designated as a hedge be reported as a component of other comprehensive income in stockholders' equity, and recorded into earnings in the period during which the hedged transaction affects earnings pursuant to SFAS No. 133. The ineffective portion on the derivative instrument is reported in current earnings as a component of interest expense.

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

### *Interest Rate Simulation Sensitivity Analysis*

Changes in market interest rates affect our estimations of the fair value of our securitization debt and the related derivatives. Changes in fair value that are stated below are derived based upon immediate and equal changes to market interest rates of various maturities. All derivative financial instruments and interest rate sensitive liabilities have been included within the sensitivity analysis presented. We model the change in value of our derivative financial instruments using outside valuation models generally recognized within the industry. Projected changes in the value of our debt as stated below are determined based on the change in net present value arising from the selected hypothetical changes in market interest rates. Changes in the fair value of our

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derivative positions with optionality have been included based on an immediate and equal change in market interest rates. The base or current interest rate curve is adjusted by the levels shown below as of March 31, 2006:

	+50 bp	+100 bp (In thousands)	-50 bp	-100 bp
Change in fair value of:				
Securitized debt subject to portfolio-based accounting	\$ (45,678)	\$ (90,857)	\$ 46,229	\$ 93,034
Derivatives related to securitized debt subject to portfolio-based accounting	43,323	86,948	(42,909)	(85,180)
Net change	\$ (2,355)	\$ (3,909)	\$ 3,320	\$ 7,854

The simulation analysis reflects our efforts to balance the repricing characteristics of our interest-bearing assets and liabilities.

**Contractual Obligations**

Our March 2006 securitization significantly increased our securitization bond financing balance from the balance at December 31, 2005. The following table summarizes our contractual obligations, excluding future interest, at March 31, 2006, and the effect such obligations are expected to have on our liquidity and cash flows in future periods:

	Total	Payments Due by Calendar Period			
		Less than 1 year	1-3 Years (In thousands)	3-5 Years	More than 5 Years
Credit facilities	\$ 16,367	\$ 16,367	\$	\$	\$
Securitization bond financing(1)	6,637,982	1,862,987	2,933,243	947,273	897,788
Total	\$ 6,654,349	\$ 1,879,354	\$ 2,933,243	\$ 947,273	\$ 897,788

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

**Off-Balance Sheet Financing Arrangements**

As of March 31, 2006, we did not have any off-balance sheet financing arrangements.

**Critical Accounting Policies**

*Accounting for Our Loan Sales*

We have sold our loans in transactions that have been accounted for in our financial statements as securitizations structured as financings. The transactions were legally structured as sales of mortgage loans, but for accounting purposes were treated as financings under SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities a replacement of FASB Statement No. 125*. When we enter into a securitization structured as a financing, the loans remain on our balance sheet, retained interests are not created for accounting purposes, 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 over the life of the securitization, instead of recognizing a gain or loss upon closing of the transaction.





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### *Estimates*

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

Provision for losses; and

Interest rate risk, derivatives and hedging strategies.

### *Provisions for Losses*

We provide market valuation adjustments on mortgage loans held for investment and real estate owned. These adjustments are based upon our estimate of expected losses, calculated using loss severity and loss frequency rate assumptions, and are based upon the value that we could reasonably expect to obtain from a sale, other than in a forced or liquidation sale. An allowance for losses on mortgage loans held for investment is recorded in an amount sufficient to maintain appropriate coverage for probable losses on such loans. The provision for losses also includes net losses on real estate owned. We periodically evaluate the estimates used in calculating expected losses, and adjustments are reported in earnings. As these estimates are influenced by factors outside of our control and as uncertainty is inherent in these estimates, it is reasonably possible that they could change.

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

### *Interest Rate Risk, Derivatives and Hedging*

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

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

### *Fair Value Hedges*

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

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### *Cash Flow Hedges*

During the third quarter of 2004, we began utilizing cash flow hedging and implemented the use of cash flow hedge accounting on our securitization debt under SFAS No. 133. Pursuant to SFAS No. 133, hedge instruments have been designated as hedging the exposure to variability of cash flows from our securitization debt attributable to interest rate risk. Cash flow hedge accounting requires that the effective portion of the gain or loss in the fair value of a derivative instrument designated as a hedge be reported in other comprehensive income, and the ineffective portion be reported in current earnings.

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

### **Risk Factors**

You should carefully consider the following risks, together with other matters described in this Form 10-Q in evaluating our business and prospects. If any of the events referred to actually occur, our business, financial condition, liquidity and results of operations could suffer. The risks described are not the only ones we face. Additional risks not presently known to us or that we currently deem immaterial may also impair our business operations. Certain statements in this Form 10-Q (including certain of the following risk factors) constitute forward-looking statements. Please refer to the section entitled "Forward-Looking Statements" on page 5 of this Form 10-Q.

### *Risks Related to REIT's Business*

#### **The distributions to be received by us with respect to our securitized mortgage pools are uncertain.**

The timing and amount of distributions to us with respect to securitized mortgage pools is not fixed and will be determined by the rate and timing of principal payments on the related mortgage loans (including prepayments and collections upon defaults, liquidations of the mortgage loans and payment of any prepayment charges), by the rate and timing of realized losses on the mortgage loans and by adjustments of the interest rates of certain classes of the underlying notes and adjustments of the interest rates of the mortgage loans.

#### **The distributions to be received by us with respect to the securitized mortgage pools are subordinated in right of payment to the securitization noteholders and to other fees and expenses of the underlying securitization trust.**

Payments on the mortgage loans in each mortgage pool will be available to make distributions to us only after payment of servicing fees, trustee fees, administrative fees, payment of other related specified expenses and reimbursements and payment of interest due to the securitization noteholders. Consequently, the amount of excess cash flow distributable to us is extremely sensitive to losses on the related mortgage loans (and the timing thereof), because certain amounts of realized losses with respect to a mortgage pool will be absorbed in the first instance by us, either by reduction in amounts otherwise to be received by us or by a reduction in the amount of over-collateralization provided to the securitization noteholders by the mortgage loans in the related mortgage pool. Overcollateralization is the excess of the aggregate outstanding scheduled principal balance of the mortgage loans in the related mortgage pool over the aggregate principal amount of the related securitization notes. Any such reduction in the amount of over-collateralization to a level below the applicable required over-collateralization amount will be borne by us, because any amounts otherwise available for distribution to us will be distributed instead to the securitization noteholders to restore the reduced amount of over-collateralization to the applicable required over-collateralization amount.

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Certain decisions by AHL or us, including, but not limited to, decisions regarding whether we exercise the clean-up call and whether or not certain principal and interest advances or servicing advances are non-recoverable, may also impact the availability of cash flow to us. The clean-up call is the option to terminate the securitization trust on any payment date when the outstanding principal balance of the notes is less than or equal to a certain designated percentage of the original principal balance of the notes. In addition, amounts otherwise to be received by us may be reduced by the right of the securitization noteholders to recover the amount of interest not paid because of the application of the applicable available funds cap rate, if any.

The available funds cap rate applicable to each of the underlying notes subject to such a ceiling is generally calculated with reference to the weighted average of the interest rates of the mortgage loans in the related mortgage pool, net of servicing and trustee fees and mortgage or bond insurance premiums.

### **The rate of prepayments and defaults on the mortgage loans in a mortgage pool will affect the timing and amount of cash flow that we will receive.**

The amount of cash flow that we will receive with respect to a securitized mortgage pool will be sensitive to the rate and timing of principal payments and realized losses on the related mortgage loans in the related mortgage pool. The amount of cash flow to us in respect of excess interest will be negatively affected by a rapid rate of principal payments and realized losses on the related mortgage loans, and the amount of distributions thereon in respect of excess interest will decrease more significantly as a result of principal payments and realized losses on the related mortgage loans with relatively high interest rates. Excess interest occurs because more interest is required to be paid by the mortgagors than is necessary to pay the interest due to the securitization noteholders and the expenses of the securitization trust. If an underlying securitization trust were terminated as a result of the exercise of the related clean-up call or an event of default under the related indenture, we would not be entitled to any further payments in respect of excess interest. There can be no assurance that the holder of the clean-up call for each securitization trust will not exercise it at the earliest opportunity.

A rapid rate of principal payments on such mortgage loans would have the effect of accelerating payments in respect of principal collections to us, and a slow rate of payment would have the effect of decelerating these payments. Generally, we will not be entitled to receive the entire excess cash flow with respect to a securitized mortgage pool prior to the date on which the related over-collateralization target has been achieved or if a trigger event (such as delinquencies or realized losses reaching a specified percentage) has occurred and is continuing with respect to that mortgage pool. Realized losses on the related mortgage loans will have the effect of reducing the over-collateralization in the related mortgage pool, and therefore reduce the amount ultimately distributable to us, although the application of excess interest may restore a reduction in the over-collateralization amount. There can be no assurance that excess interest will be available for this purpose.

The terms of certain mortgage loans provide for payment by the related mortgagor of a prepayment charge in limited circumstances on certain prepayments. Any prepayment charges paid in respect to the mortgage loans in a mortgage pool will be used to make required payments by the related securitization trust, and any funds in excess thereof will be distributed to us. Generally, each prepayment charge only remains applicable with respect to the related mortgage loan for a limited period of time. In addition, under certain instances, the payment of any otherwise applicable prepayment charge may be waived by AHL, as the underlying servicer.

### **The securitized mortgage loans may include mortgage loans with LTVs in excess of 80%, which may present a greater risk of loss.**

A portion of the mortgage loans in each of our securitized mortgage pools had a loan-to-value ratio ( LTV ) at origination in excess of 80% and is not covered by a primary mortgage insurance policy. Mortgage loans with higher LTVs may present a greater risk of loss. There can be no assurance that the LTV of any mortgage loan determined at any time after origination is less than or equal to its original LTV.

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### **The over-collateralization requirement of each securitization trust will affect the rate and timing of distributions to be received by us.**

Each securitized mortgage pool is subject to an over-collateralization requirement. The required over-collateralization amount for each underlying securitization trust will be determined as set forth in the related underlying indenture and sale and servicing agreement. No payments will be received by us with respect to a mortgage pool until the then-applicable required over-collateralization amount has been reached and maintained.

The related required over-collateralization amount with respect to a securitization trust may be permitted to decrease, subject to certain conditions specified in the related indenture and sale and servicing agreement. If such conditions have been satisfied, collections of principal that would otherwise be distributed as a payment of principal to the related securitization noteholders will instead be received by us. Conversely, if at any time certain delinquency and/or loss levels are exceeded with respect to a mortgage pool, there will be a delay in the reduction of the related required over-collateralization amount or there may be an increase in the related required over-collateralization amount. There may be significant periods during which no or limited distributions will be made to us in respect of our retained interests in securitized mortgage pools.

### **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 our securitized loans subject to portfolio based accounting, as reflected in the Interest Rate Simulation Sensitivity Analysis in the section entitled Market Risk in ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations. 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 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 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. See discussion under Market Risk under ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

### **The distributions to us may be subject to basis risk in the difference between One-Month LIBOR and Six-Month LIBOR.**

Certain of the underlying securitization trusts have been structured such that a group of adjustable-rate mortgage loans collateralize a class of variable-rate notes. These notes have interest rates based upon One-Month LIBOR, while the interest rates on the related mortgage loans are based upon Six-Month LIBOR, subject to periodic adjustments and limitations on such adjustments. In a rising interest rate environment, the interest rates on the notes may rise more quickly than the interest rates of the mortgage loans. As a consequence, cash flow resulting from excess interest on the mortgage loans, and accordingly, amounts distributable to us may be substantially reduced. The interest payments payable on the notes may be subject to an available funds cap rate. If a rising interest rate environment, or a disproportionately high rate of prepayments (including prepayments and collections upon defaults, liquidations) and realized losses on the mortgage loans in the related mortgage pool with relatively high interest rates, causes the interest rate on the related notes to equal the available funds cap rate applicable thereto, then the excess interest amount is generated by the portion of each underlying securitization trust represented by the principal balance of the related notes may be used to make a compensatory payment to noteholders.

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The notes that are subject to basis risk shortfalls as described above will be entitled to recover the amount of any such shortfalls, with interest thereon, to the extent that excess cash flow or other amounts become available to fund such recovery. Any amounts paid directly or indirectly from excess cash flow to the securitization noteholders in respect of any such shortfalls will reduce the excess interest amounts that would otherwise be distributable to us and may reduce the amount of over-collateralization release that would otherwise be available to us and will therefore not be available to us.

Other underlying securitization trusts have been structured such that a group of fixed- and adjustable-rate mortgage loans collateralize a class of variable-rate notes. The cash flow distributed to us under this structure is also subject to the basis risk described above, to the extent of the adjustable-rate mortgage loans, and the basis risk created by issuing variable-rate notes collateralized by fixed-rate mortgage loans. As market interest rates rise, the interest rate on the senior notes rises, but the interest rate on the fixed-rate mortgage loans remains constant, thereby reducing the excess interest available for distribution to us.

**The geographic concentration of the mortgaged properties securing our securitized mortgage loans may create risks of greater losses associated with adverse conditions that may arise in areas of concentration.**

Our securitized mortgage loans have certain geographic concentrations in a number of states, which may present a greater risk of loss if conditions in those states become adverse. In these states, if the residential real estate market should experience an overall decline in property values after the dates of origination of the mortgage loans, the rates of delinquencies, foreclosures, bankruptcies and losses on the mortgage loans may increase over historical levels of comparable type loans, and may increase substantially. In addition, properties located in California and Florida may be more susceptible than homes located in other parts of the country to certain types of uninsured hazards, such as earthquakes, wildfires, hurricanes, floods, mudslides and other natural disasters. As of March 31, 2006, 22% and 11% of the unpaid principal amounts of the mortgage loans in our portfolio were secured by properties located in California and Florida, respectively.

**Our securitized mortgage loans are underwritten to standards that generally do not conform to the credit criteria required by Fannie Mae and Freddie Mac, and therefore may experience higher levels of delinquencies and losses.**

All of our securitized mortgage loans have been originated and underwritten by AHL. In general, AHL originates and acquires mortgage loans that do not meet the credit criteria required by Fannie Mae and Freddie Mac. These nonconforming mortgage loans may tend to exhibit higher levels of delinquency and loss than mortgage loans, which conform to the requirements of Fannie Mae and Freddie Mac. The interest rates and the LTVs for such mortgage loans are established at levels designed to compensate for and offset the increased delinquency, foreclosure and loss risks presented by such loans. No assurances can be given, however, that the loans in any underlying securitization trust will not exceed expected delinquency, foreclosure and loss levels and adversely affect the amount and value of the cash flow to be received by us.

**The diversification of the properties securing our interest in mortgage loans is limited, and the liquidation of a mortgage pool after the occurrence of an event of default could greatly reduce or even eliminate the amount distributable to us.**

Although our assets consists primarily of the right to receive cash flows from mortgage pools and we benefit from the diversification of risks associated with the mortgage pools, the mortgage pools contain mortgage loans originated or acquired by AHL under AHL's underwriting standards and serviced by AHL as servicer. Accordingly, any benefits arising from the diversification of the properties securing our interest in mortgage loans will be limited. Furthermore, there is no cross-collateralization between the underlying securitization trusts.

**We may be adversely affected by litigations to which we or Accredited may become a party.**

We may in the future become a defendant in lawsuits which seek to recover substantial amounts from us. No assurances can be given that we will be able to successfully defend all or any of such lawsuits, and adverse

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results in one or more of such lawsuits could have a material adverse effect on us. In addition, we could be adversely affected by litigation to which Accredited is a party.

**If we fail to maintain our status as a real estate investment trust, we will be subject to federal or state income tax on taxable income at regular corporate rates.**

We were organized to qualify for taxation as a real estate investment trust under the Internal Revenue Code of 1986, as amended (the Code ). We have conducted, and intend to continue to conduct, our 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 our control. For instance, in order to qualify as a real estate investment trust, no more than 50% of the value of our outstanding shares of beneficial interest may be beneficially owned, directly or indirectly, by five or fewer individuals (as defined in the Code to include certain entities) (the Ownership Test ) during the last six months of our taxable year. Furthermore, each year we must distribute to our shareholders at least 90% of our taxable income (the Annual Distribution Requirements ). We cannot assure you that we will at all times satisfy these rules and tests.

If we were to fail to qualify as a real estate investment trust in any taxable year, as a result of a determination that we failed to meet the Ownership Test, the Annual Distribution Requirement or any other requirement, we would be subject to federal and state income tax, including any applicable alternative minimum tax, on our taxable income at regular corporate rates. Moreover, unless entitled to relief under certain statutory provisions, we 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 our net earnings and cash flow available for distribution to shareholders. Additionally, distributions to shareholders would no longer be required to be made by us. Accordingly, our failure to qualify as a real estate investment trust could have a material adverse impact on our financial results and the value of our Series A Preferred Shares.

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

**Our shareholders may be adversely affected by our ownership of residual interests in taxable mortgage pools.**

We have completed securitizations of mortgage loans using a taxable mortgage pool structure and have retained the residual interest in these securitizations. The U.S. Treasury Department has authority to issue regulations treating a portion of the income from a residual interest in a taxable mortgage pool held by a real estate investment trust as excess inclusion income as defined in Section 860E of the Internal Revenue Code. The U.S. Treasury Department has yet to exercise that authority. Under such circumstances, it is likely that the REIT's shareholders would be subject to tax on their allocable share of the REIT's excess inclusion income. If so, our shareholders generally would not be able to offset their share of excess inclusion income with any current, carryforward or carryback net operating losses. In addition, it is likely that tax exempt entities that own shares in us would be required to treat their allocable share of excess inclusion income as unrelated business taxable income. Further, any portion of our dividends paid to foreign shareholders that is allocable to excess inclusion income would not be eligible for exemption from the 30% withholding tax (or reduced treaty rate) on dividend

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income. Finally, if our shares are held or acquired by disqualified organizations as defined in Section 860E, then we would be subject to an entity level tax on the excess inclusion amount allocated to such shareholders, at the highest rate of tax imposed on corporations. If imposed, such entity level tax would be deductible to the REIT. It is possible that we will continue to use the taxable mortgage pool structure in our future securitizations.

**The early termination of an underlying securitization trust could substantially reduce or even eliminate the amount of distributions that would otherwise be received by us.**

*Upon exercise of clean-up call.* Each securitization trust is structured such that, when the aggregate outstanding principal balance of the notes has declined to a level less than or equal to a specified amount (typically 10%) of the original aggregate principal balance, then a specified party has the option to purchase the remaining mortgage loans from the trust, causing the securitization trust to call its outstanding notes and terminate the trust. The party holding this option is AHL, in the case of securitization transactions executed by AHL, and us, in the case of transactions executed by us. There can be no assurance that the holder of the clean-up call for each securitization trust will not exercise it at the earliest opportunity.

*Upon declaration of event of default.* In addition, the indenture with respect to each series of securitization notes issued by a securitization trust includes events of default which, if they occur and are not cured within the applicable cure period, entitle the related controlling party to declare an event of default and cause the trustee to liquidate the mortgage loans.

If a clean-up call were exercised or if a mortgage pool were liquidated as a result of and declaration of an event of default, we would only be entitled to receive that portion of the proceeds on the mortgage loans not required to make payment in full of the principal and accrued and unpaid interest to the securitization noteholders, plus any unpaid fees and expenses of the servicer and the trustees, and any unpaid amounts owed to the note insurer. There can be no assurance that any such amount would not be substantially less than the amount that would otherwise be distributable to us had such clean-up call or liquidation not occurred.

### *Risks Relating to the Terms of REIT's Series A Preferred Shares*

**The timing and amount of contributions of additional assets to us by our parent are uncertain, and our existing assets may not generate sufficient funds to pay the preferred dividend.**

AHL, our parent, intends to contribute pools of mortgage loans from time to time to us, which will be subject to warehouse indebtedness, in order to facilitate securitization transactions to be executed by us. AHL intends to contribute these pools of mortgage loans as is required by the level of originations of mortgage loans by AHL, among other factors. To the extent that the market for whole loans provides execution on more favorable terms than securitization, it is possible that the securitizations executed by us will consist of smaller pools and will be executed less frequently than would otherwise be the case. In addition, we intend to operate in a manner that will not subject us to regulation under the Investment Company Act; in order to satisfy the requirements for exemptive relief from regulation under the Investment Company Act, we may be subject to restrictions on our operations, including our ability to acquire certain types of mortgage assets. Notwithstanding AHL's intention to contribute mortgage assets to us, it is under no obligation to do so.

**The Series A Preferred Shares rank subordinate to claims of our creditors and equally with any other parity shares we may issue, and the Series A Preferred Shareholders' ability to receive dividends or the liquidation preference is therefore limited.**

The Series A Preferred Shares rank subordinate to all claims of our existing and future creditors. As a result, upon any distribution to our creditors in a bankruptcy, liquidation or reorganization or similar proceeding, the holders of our indebtedness will be entitled to be paid in full in cash before any payment may be made to holders of the Series A Preferred Shares. We may incur substantial indebtedness in the future.



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In addition, with the approval of a majority of our Board of Trustees and obtaining the approval of a majority of our independent trustees, we may issue authorized parity shares at any time in the future without your consent or approval. Accordingly, if:

we do not have funds legally available to pay full dividends on our Series A Preferred Shares and any other parity shares we may issue; or

we do not have funds legally available to pay the full liquidation value of our Series A Preferred Shares and any parity shares in the event of our liquidation, dissolution or winding up,

then any funds that are legally available to pay such amounts will be paid pro rata to holders of our Series A Preferred Shares and any of our parity shares then outstanding.

**The guarantee of the Series A Preferred Shares is subordinate to claims of Accredited's creditors and effectively subordinated to the creditors of Accredited's subsidiaries.**

Accredited's guarantee of the Series A Preferred Shares ranks behind all of its existing and future indebtedness. As a result, upon any distribution to Accredited's creditors in a bankruptcy, liquidation or reorganization or similar proceeding, the holders of indebtedness of Accredited will be entitled to be paid in full in cash before any payment may be made to holders of the Series A Preferred Shares under the guarantee.

The guarantee also will effectively rank junior to all liabilities of Accredited's subsidiaries, including AHL. Accredited is a holding company and its assets consist primarily of investments in its subsidiaries. Substantially all of the consolidated liabilities of Accredited have been incurred by its subsidiaries. Therefore, Accredited's rights 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 Accredited may itself be a creditor with recognized claims against the subsidiary (in which case the claims of Accredited 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 Accredited).

The guarantee is an obligation exclusively of Accredited. Accredited's ability to make payments on the guarantee is dependent primarily upon the earnings of its subsidiaries and the distribution or other payment of such earnings to Accredited in the form of dividends, loans or advances and repayment of loans and advances from Accredited. The subsidiaries are separate and distinct legal entities and have no obligation, contingent or otherwise, to pay any amounts due pursuant to the guarantee or to make any funds available therefore, whether by dividends, loans or other payments. The payment of dividends, or the making of loans and advances to Accredited by its subsidiaries, may be subject to statutory or regulatory restrictions, is contingent upon the earnings of those subsidiaries and is subject to various business considerations.

At March 31, 2006, the guarantee would have been effectively subordinated to approximately \$9.1 billion of indebtedness, including warehouse and securitization indebtedness but excluding intercompany indebtedness, of Accredited and debt obligations of its subsidiaries. Accredited and its subsidiaries may incur substantial additional indebtedness in the future.

**Holders of our Series A Preferred Shares have very limited voting rights and, except in limited circumstances, will not be able to elect trustees or influence other matters submitted to a vote of our shareholders.**

Although our Series A Preferred Shares have voting rights, these voting rights are very limited. All series of our preferred shares that provide for such voting rights will have the right to collectively in the aggregate cast 15% of the votes cast by shareholders on all matters put to our shareholders generally for a vote. This voting right will be allocated among the preferred shares according to their liquidation preference. The holders of the

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common shares will have the right to cast 85% of the votes on such matters. AHL currently holds all of our outstanding common shares of beneficial interest and, accordingly, controls enough voting power to determine the outcome of matters submitted to a vote of our shareholders, including the election of trustees.

Whenever dividends on any of the Series A Preferred Shares or any series of preferred shares ranking on a parity as to the payment of dividends with the Series A Preferred Shares shall be in arrears for six or more quarterly periods (whether consecutive or not), the holders of such Series A Preferred Shares (voting separately as a class with all other series of our preferred shares ranking on a parity with the Series A Preferred Shares as to the payment of distributions and the distribution of assets upon liquidation upon which like voting rights have been conferred and are exercisable) will be entitled to vote for the election of a total of two additional members of our Board of Trustees. In addition, the Series A Preferred Shares will have the right to participate in the vote of all matters put to the preferred shares voting as a class, such vote to be determined by reference to their liquidation preference.

All of our trustees and officers are also directors and/or officers of Accredited and may conduct our business in a manner that serves Accredited's interests better than the interests of holders of the Series A Preferred Shares.

### **There may be adverse effects from Accredited's ownership of all of our common shares.**

Accredited is involved in virtually every aspect of our existence. AHL is the sole holder of our common shares of beneficial interest and acts as servicer of the securitized mortgage loans. In addition, all of our officers and trustees are also officers and/or directors of Accredited. As the holder of all of our outstanding common shares of beneficial interest, except in limited circumstances, AHL will have the right to elect all of our trustees, including our independent trustees.

Accredited may have interests which are not identical to ours. Consequently, conflicts of interest may arise with respect to transactions, including without limitation, our acquisition of mortgage loans from AHL; servicing of mortgage loans; future dispositions of mortgage loans; and the provision by AHL of advisory services to us. It is our intention and that of Accredited that any agreements and transactions between us, on the one hand, and Accredited and/or its affiliates, on the other hand, are fair to all parties and consistent with market terms, including the servicing of mortgage loans. However, there can be no assurance that such transactions will be on terms as favorable to us as those that could have been obtained from unaffiliated third parties.

### **We are economically and operationally dependent on AHL.**

We acquire mortgage assets and assume related funding obligations from AHL, who also provides operating facilities, administration and servicing for us. Accordingly, we are economically and operationally dependent on AHL, and, as such, our results of operation or financial condition may not be indicative of the conditions that would have existed if we had operated as an unaffiliated entity.

### **We may fail to qualify as a real estate investment trust, which would permit us to redeem the Series A Preferred Shares under certain circumstances.**

We intend to be owned, organized and operated so as to qualify as a real estate investment trust under the Internal Revenue Code. Although we believe that we will be owned and organized and will operate in such a manner, it is not certain that we will be able to remain qualified as a real estate investment trust for federal income tax purposes. Our qualification as a real estate investment trust depends on, among other factors, the distribution annually of at least 90% of our taxable income, determined before any deduction for dividends paid and excluding any net capital gains, the nature of our assets, the manner of our operation, our organization, our capital structure and the ownership of our equity. Qualification as a real estate investment trust involves the application of highly technical and complex tax law provisions for which there are only limited judicial or administrative interpretations and involves the satisfaction of various requirements not entirely within our

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control. No assurance can be given that new legislation, Treasury regulations, administrative interpretations or court decisions will not significantly change the tax laws with respect to qualification as a real estate investment trust or the federal income tax consequences of such qualification in a way that would have a material adverse effect on our ability to qualify as a real estate investment trust. Any such new legislation, Treasury regulation, interpretation or decision could be the basis of a tax event that would permit us to redeem our Series A Preferred Shares, subject to certain conditions, for the amount of the liquidation preference per share of our Series A Preferred Shares plus accrued and unpaid dividends to, but excluding, the redemption date.

Although we intend to be owned, organized and operated in a manner that allows us to qualify and remain qualified as a real estate investment trust, future economic, market, legal, tax or other considerations may cause us to determine that it is in our best interests and the best interests of holders of our common shares of beneficial interest and preferred shares to revoke our election to be treated as a real estate investment trust. Any such determination by us may be made without shareholder approval but, as long as any shares of the Series A Preferred Shares are outstanding, will require the prior approval of a majority of our independent trustees (as defined in the terms of our Series A Preferred Shares).

Recent changes as well as possible future changes to federal tax laws could make stock in non-REIT corporations more attractive to investors than stock in real estate investment trusts and thereby negatively affect the value of and market for the Series A Preferred Shares.

### **We may redeem our Series A Preferred Shares upon the occurrence of a tax event or an investment company event, subject to additional conditions.**

At any time following the occurrence of a tax event or an investment company event, even if such tax event or investment company event occurs prior to September 30, 2009 (which would otherwise be the first day on which we could redeem the Series A Preferred Shares), we will have the right but not the obligation to redeem our Series A Preferred Shares in whole for an amount equal to the liquidation preference per share, plus accrued and unpaid dividends, if any, to, but excluding, the date of redemption, subject to certain additional conditions. The occurrence of a tax event or an investment company event will not, however, give a shareholder any right to require us to redeem our Series A Preferred Shares. A tax event will generally occur if we receive an opinion of counsel to the effect that, as a result of a judicial decision or official administrative pronouncement, ruling or regulatory procedure or as a result of changes in the tax laws, regulations or related official interpretations, there is a more than insubstantial risk that dividends with respect to our shares of beneficial interest will not be fully deductible by us or we will be subject to more than a de minimus amount of additional taxes or governmental charges. An investment company event generally will occur if we receive an opinion of counsel to the effect that there is more than an insubstantial risk that we are or will be considered an investment company within the meaning of the Investment Company Act as a result of any judicial decision, any pronouncement or interpretation, the adoption or amendment of any law, rule or regulation, any notice or announcement by any U.S. legislative body, court, governmental agency or regulatory authority, in each case after the initial issuance of Series A Preferred Shares.

### **The ownership limitations and restrictions on transfer relating to the Series A Preferred Shares could have adverse consequences to us.**

In order to facilitate our compliance with the requirements to qualify as a real estate investment trust under the Internal Revenue Code, our Declaration of Trust contains certain ownership limitations and transfer restrictions relating to our Series A Preferred Shares. The Declaration of Trust provides that no person may own, or be deemed to own by virtue of the attribution provisions of the Internal Revenue Code, more than 9.8% (the Aggregate Share Ownership Limit) of the value of our outstanding common and preferred shares of beneficial interest. In addition, the Declaration of Trust further prohibits (a) any person from beneficially or constructively owning shares of beneficial interest of us that would result in us being closely held under Section 856(h) of the Internal Revenue Code or otherwise cause us to fail to qualify as a real estate investment trust and (b) any person

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from transferring our shares of beneficial interest if such transfer would result in our shares of beneficial interest being owned by fewer than 100 persons. Any person who acquires or attempts or intends to acquire beneficial or constructive ownership of our shares of beneficial interest that will or may violate any of the foregoing restrictions on transferability and ownership is required to give notice immediately to us and provide us with such other information as we may request in order to determine the effect of such transfer on our status as a real estate investment trust. The Aggregate Share Ownership Limit does not apply to the common shares owned, directly or indirectly, by AHL.

If any transfer of our shares of beneficial interest or any other event occurs which, if effective, would result in any person beneficially or constructively owning our shares of beneficial interest in excess or in violation of the above transfer or ownership limitations (a Prohibited Owner), that number of our shares of beneficial interest, the beneficial or constructive ownership of which otherwise would cause such person to violate such limitations (rounded to the nearest whole share) will be transferred to a charitable trust and in such event the Prohibited Owner will not be entitled to benefit economically from such shares, will not be entitled to rights to dividends in respect of such shares and will not possess any rights to vote or other rights attributable to such shares.

Whether or not a holder of Series A Preferred Shares is or becomes a Prohibited Owner will depend both on the number of shares owned by such holder and the relative values of our common and preferred shares. Fluctuations in the relative value of our common shares, the Series A Preferred Shares and any other preferred shares then outstanding could cause a holder of Series A Preferred Shares to inadvertently become a Prohibited Owner, which could have negative economic and other consequences to such holder. Our common shares are not publicly traded and establishing their value may be difficult. If it were determined by the Internal Revenue Service, and subsequently upheld by a court or other administrative body that our valuation was unreasonable, and because of the valuation error we were to become closely held, we would cease to qualify as a real estate investment trust under the Internal Revenue Code and would be subject to corporate level tax.

**Our warehouse credit facilities contain covenants that restrict our operations and may inhibit our ability to grow our business and increase revenues.**

Our warehouse credit facilities contain extensive restrictions and covenants. If we fail to meet or satisfy any of these covenants, we would be in default under these agreements and our lenders could elect to declare all amounts outstanding under the agreements to be immediately due and payable, enforce their interests against collateral pledged under such agreements and restrict our ability to make additional borrowings. 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.

The covenants and restrictions in our warehouse credit facilities may restrict our ability to, among other things:

make certain investments or acquisitions;

repurchase or redeem capital stock;

engage in mergers or consolidations;

finance loans with certain attributes; and

hold loans for longer than established time periods.

These restrictions may interfere with our ability to obtain financing or to engage in other business activities, which may significantly harm our business, financial condition, liquidity and results of operations.

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**ITEM 3. Quantitative and Qualitative Disclosures About Market Risk**

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

**ITEM 4. Controls and Procedures**

*Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures*

(a) Evaluation of Disclosure Controls and Procedures. The REIT maintains controls and procedures designed to ensure that it is able to collect the information it is required to disclose in the reports it files with the SEC, and to process, summarize and disclose this information within the time periods specified in the rules of the SEC. Based on an evaluation of the REIT's disclosure controls and procedures as of the end of the period covered by this report conducted by the REIT's management, the Chief Executive and Chief Financial Officers believe that these controls and procedures are effective to ensure that the REIT is able to collect, process and disclose the information it is required to disclose in the reports it files with the SEC within the required time periods.

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

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**PART II**

**ITEM 1. Legal Proceedings**

We are not currently the subject of any litigation. We are not currently involved in nor, to our knowledge, currently threatened with any material litigation with respect to the assets included in our portfolio.

Legal proceedings to which Accredited is a party are described in its quarterly report on Form 10-Q for the period ended March 31, 2006.

**ITEM 1A. Risk Factors**

We have provided updated risk factors in the section labeled "Risk Factors" in Part I, Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations. While the "Risk Factors" section provides updated information in specific areas (such as delinquency rate and loan repurchases, financing rates, geographic concentration of loans, and prepayment rates), we do not believe that these updates materially change the type or magnitude of the risks we face in comparison to the disclosure provided in our most recent Annual Report on Form 10-K.

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

None.

**ITEM 3. Defaults Upon Senior Securities**

None.

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

None.

**ITEM 5. Other Information**

None.

**ITEM 6. Exhibits**

For a list of exhibits filed with this Quarterly Report on Form 10-Q, refer to the Exhibit Index beginning on page 41.

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**SIGNATURES**

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

Dated: May 9, 2006

ACCREDITED MORTGAGE LOAN REIT TRUST

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

BY: /s/ JOHN S. BUCHANAN  
*John S. Buchanan*  
*Chief Financial Officer*  
*(Principal Financial and Accounting Officer)*

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**EXHIBIT INDEX**

3.1 <sup>(1)</sup>	Declaration of Trust of the Registrant.
3.2 <sup>(2)</sup>	Articles Supplementary to Declaration of Trust of Accredited Mortgage Loan REIT Trust dated August 11, 2004.
3.3 <sup>(3)</sup>	Articles Supplementary to Declaration of Trust of Accredited Mortgage Loan REIT Trust dated October 4, 2004.
3.4 <sup>(1)</sup>	Amended and Restated Bylaws of the Registrant.
4.1 <sup>(2)</sup>	Specimen certificate for Accredited Mortgage Loan REIT Trust's preferred shares of beneficial interest.
4.2 <sup>(2)</sup>	Guarantee Agreement of Accredited Home Lenders Holding Co., dated as of August 12, 2004.
4.3 <sup>(3)</sup>	Guarantee Agreement of Accredited Home Lenders Holding Co., dated as of October 6, 2004.
4.4 <sup>(4)</sup>	Indenture, dated as of March 1, 2006, between Accredited Mortgage Loan Trust 2006-1, a Delaware statutory trust acting through its owner trustee and Deutsche Bank National Trust Company, as Indenture Trustee.
4.5 <sup>(4)</sup>	Amended and Restated Trust Agreement, dated as of March 28, 2006, among Accredited Home Lenders, Inc., Accredited Mortgage Loan REIT Trust, and U.S. Bank National Association, as Owner Trustee.
4.6 <sup>(4)</sup>	Sale and Servicing Agreement, dated as of March 1, 2006, among Accredited Home Lenders, Inc., as Sponsor and as Servicer, and Accredited Mortgage Loan Trust 2006-1, as Issuer and the Indenture Trustee.
4.7 <sup>(4)</sup>	Master Agreement, dated March 28, 2006, between Accredited Mortgage Loan Trust 2006-1 and Swiss Re Financial Products Corporation.
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1 <sup>(5)</sup>	Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350)
32.2 <sup>(5)</sup>	Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350)

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(1) Incorporated by Reference to the Company's Amendment No. 2 to Registration Statement on Form S-3 (File No. 333-117484-01) dated August 5, 2004.

(2) Incorporated by Reference to the Company's Current Report on Form 8-K (File No. 000-50179) dated August 9, 2004.

(3) Incorporated by Reference to the Company's Current Report on Form 8-K (File No. 001-32275) dated October 1, 2004.

(4) Incorporated by Reference to the Company's Current Report on Form 8-K (File No. 333-124435-01) dated April 10, 2006.

(5) The information contained in these certifications is furnished to the Securities and Exchange Commission pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not be incorporated by reference into any filing with the Securities and Exchange Commission made by the Company whether before or after the date hereof, regardless of any general incorporation language in such filing.