

ARBOR REALTY TRUST INC  
Form 10-K  
March 03, 2017

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

**Form 10-K**

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

**For the fiscal year ended December 31, 2016**

or

o **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: 001-32136**

**Arbor Realty Trust, Inc.**

(Exact name of registrant as specified in its charter)

**Maryland**  
(State or other jurisdiction  
of incorporation)

**20-0057959**  
(I.R.S. Employer  
Identification No.)

**333 Earle Ovington Boulevard, Suite 900,  
Uniondale, NY**

(Address of principal executive offices)

**11553**  
(Zip Code)

(Registrant's telephone number, including area code): **(516) 506-4200**

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>
Common Stock, par value \$0.01 per share	New York Stock Exchange
Preferred Stock, 8.25% Series A Cumulative Redeemable, par value \$0.01 per share	New York Stock Exchange
Preferred Stock, 7.75% Series B Cumulative Redeemable, par value \$0.01 per share	New York Stock Exchange
Preferred Stock, 8.50% Series C Cumulative Redeemable, par value \$0.01 per share	New York Stock Exchange
7.375% Senior Unsecured Notes due in 2021	New York Stock Exchange

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

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

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

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  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer       Accelerated filer       Non-accelerated filer       Smaller reporting company   
(Do not check if a smaller reporting company)

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

The aggregate market value of the registrant's common stock, all of which is voting, held by non-affiliates of the registrant as of June 30, 2016 (computed based on the closing price on such date as reported on the NYSE) was \$307.4 million. As of February 24, 2017, the registrant had 51,401,295 shares of common stock outstanding.

### DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive proxy statement for the registrant's 2017 Annual Meeting of Stockholders (the "2017 Proxy Statement"), to be filed within 120 days after the end of the registrant's fiscal year ended December 31, 2016 are incorporated by reference into Part III of this Annual Report on Form 10-K.

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**Forward-Looking Statements**

This report contains certain "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements relate to, among other things, the operating performance of our investments and financing needs. We use words such as "anticipates," "expects," "believes," "intends," "should," "will," "may" and similar expressions to identify forward-looking statements, although not all forward-looking statements include these words. Forward-looking statements are based on certain assumptions, discuss future expectations, describe future plans and strategies, contain projections of results of operations or of financial condition or state other forward-looking information. Our ability to predict results or the actual effect of future plans or strategies is inherently uncertain. These forward-looking statements involve risks, uncertainties and other factors that may cause our actual results in future periods to differ materially from forecasted results. Factors that could have a material adverse effect on our operations and future prospects include, but are not limited to, changes in economic conditions generally and the real estate market specifically; adverse changes in the financing markets we access affecting our ability to finance our loan and investment portfolio; adverse changes in our status with government-sponsored enterprises affecting our ability to originate loans through such programs; changes in interest rates; the quality and size of the investment pipeline and the rate at which we can invest our cash; impairments in the value of the collateral underlying our loans and investments; changes in federal and state laws and regulations, including changes in tax laws; the availability and cost of capital for future investments; and competition. Readers are cautioned not to place undue reliance on any of these forward-looking statements, which reflect management's views as of the date of this report. The factors noted above could cause our actual results to differ significantly from those contained in any forward-looking statement. For a discussion of our critical accounting policies, see "Management's Discussion and Analysis of Financial Condition and Results of Operations of Arbor Realty Trust, Inc. and Subsidiaries Significant Accounting Estimates and Critical Accounting Policies" under Item 7 of this report.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. We are under no duty to update any of the forward-looking statements after the date of this report to conform these statements to actual results.

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**PART I**

**Item 1. Business**

In this Annual Report on Form 10-K we refer to Arbor Realty Trust, Inc. and subsidiaries as "we," "us," "our," or the "Company" unless we specifically state otherwise or the context indicates otherwise.

**Overview**

Arbor Realty Trust, Inc. is a Maryland corporation formed in 2003 and is externally managed and advised by Arbor Commercial Mortgage, LLC ("ACM" or our "Manager"), pursuant to the terms of a management agreement described below. We invest in a diversified portfolio of structured finance assets in the multifamily and commercial real estate markets, primarily consisting of bridge and mezzanine loans, including junior participating interests in first mortgages, preferred and direct equity. In addition, we may also directly acquire real property and invest in real estate-related notes and certain mortgage-related securities. We refer to this platform as our Structured Loan Origination and Investment Business, or "Structured Business." As a result of the acquisition of the agency platform of our Manager on July 14, 2016 (the "Acquisition"), we also now originate, sell and service a range of multifamily finance products through the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac," and together with Fannie Mae, the government-sponsored enterprises, or the "GSEs"), the Government National Mortgage Association ("Ginnie Mae"), Federal Housing Authority ("FHA") and the U.S. Department of Housing and Urban Development (together with Ginnie Mae and FHA, "HUD") and the conduit/commercial mortgage-backed securities ("CMBS") programs. We retain the servicing rights and asset management responsibilities on substantially all loans we originate and sell under the GSE and HUD programs. We are an approved Fannie Mae Delegated Underwriting and Servicing ("DUS") lender nationally, a Freddie Mac Multifamily Conventional Loan lender, seller/servicer, in New York, New Jersey and Connecticut, a Freddie Mac affordable, manufactured housing, senior housing and small balance loan ("SBL") lender, seller/servicer, nationally and a HUD MAP and LEAN senior housing/healthcare lender nationally. We refer to this platform as our Agency Loan Origination and Servicing Business, or "Agency Business." See Acquisition of Our Manager's Agency Platform below for further details about the Acquisition.

Substantially all of our operations are conducted through our operating partnership, Arbor Realty Limited Partnership ("ARLP"), for which we serve as the general partner, and ARLP's subsidiaries.

We are organized to qualify as a real estate investment trust ("REIT") for U.S. federal income tax purposes. A REIT is generally not subject to federal income tax on that portion of its REIT taxable income that is distributed to its stockholders, provided that at least 90% of taxable income is distributed and provided that certain other requirements are met. Certain of our assets that produce non-qualifying income, primarily within the Agency Business, are operated through taxable REIT subsidiaries ("TRS"), which is part of our TRS consolidated group (the "TRS Consolidated Group") and is subject to U.S. federal, state and local income taxes. In general, our TRS entities may hold assets that the REIT cannot hold directly and may engage in real estate or non-real estate-related business.

**Acquisition of Our Manager's Agency Platform**

On July 14, 2016 we completed the Acquisition for an aggregate purchase price of \$275.8 million, which was paid with \$138.0 million in stock, \$87.8 million in cash and with the issuance of a \$50.0 million seller financing instrument. The closing price of our common stock on the Acquisition date was \$7.29 per share; therefore, the estimated fair value of the total consideration given to our Manager approximated \$292.5 million. As a result of the Acquisition, we now evaluate our results of operations based on two business segments: Structured Business and Agency Business. See

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Note 3 Acquisition of Our Manager's Agency Platform and Note 22 Segment Information for additional details of the Acquisition and segments.

**Business Objectives and Strategy**

Our principle business objectives are to maximize the difference between the yield on our investments and the cost of financing these investments, and to grow our agency platform and the stable earnings associated with our servicing portfolio, to generate cash available for distribution and facilitate capital appreciation. We believe we can achieve these objectives and maximize the total return to our stockholders through the investment strategies described below:

***Investment Strategy***

The financing of multifamily and commercial real estate offers opportunities that demand customized financing solutions. We believe that providing both structured products and agency loans through direct originations and in-house underwriting capabilities throughout our national network of sales offices and lending solutions through various GSE and HUD programs provides us with a competitive advantage, since this allows us to meet the multiple needs of our borrowers through a fully integrated comprehensive product offering. We employ the following investment strategies:

***Provide Customized Financing.*** We provide customized financing to meet the needs of our borrowers. We target borrowers whose options may be limited by conventional bank financing, have demonstrated a history of enhancing the value of the properties they operate and who may benefit from the customized financing solutions we offer.

***Execute Transactions Rapidly.*** We act quickly and decisively on proposals, provide commitments and close transactions within a few weeks and sometimes days, if required. We believe that rapid execution attracts opportunities from both borrowers and other lenders that would not otherwise be available. We believe our ability to structure flexible terms and close loans in a timely manner gives us a competitive advantage.

***Manage Credit Quality.*** A critical component of our strategy is our ability to manage the real estate risk associated with our investment portfolio. We actively manage the credit quality of our portfolio by using the expertise of our asset management group, which has a proven track record of structuring and repositioning finance investments to improve credit quality and yield.

***Use Our Relationships with Existing Borrowers.*** We capitalize on our reputation in the commercial real estate finance industry. We have relationships with a large borrower base nationwide. Since our originators offer a wide range of customized financing solutions, we are able to benefit from the existing customer base and use existing business as means of potential refinancing opportunities.

***Long-Established Relationships with GSE's.*** Our Agency Business benefits from our long-established relationships with Fannie Mae, Freddie Mac, HUD and Ginnie Mae enabling us to offer a broad range of loan products and services which maximizes our ability to meet our borrowers' needs.

***Leverage the Experience of Executive Officers, Our Manager and Our Employees.*** Our executive officers and employees, and those of our Manager, have extensive experience originating and managing structured commercial real estate investments. Our senior management team has, on average, over 20 years of experience in the financial services industry.

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***Our Primary Targeted Investments***

We pursue short-term and long-term lending and investment opportunities and primarily target transactions where we believe we have competitive advantages, particularly our lower cost structure and in-house underwriting capabilities.

Through our Structured Business, we focus primarily on the following investment types:

***Bridge Financing.*** We offer bridge financing products to borrowers who are typically seeking short-term capital to use in an acquisition of property. The borrower has usually identified an undervalued asset that has been under managed and/or is located in a recovering market. From the borrower's perspective, shorter term bridge financing is advantageous because it allows for time to improve the property value without encumbering it with restrictive, long-term debt that may not reflect optimal leverage for a non-stabilized property.

Our bridge loans typically range in size from \$5 million to \$30 million, have an interest rate range typically between 5% to 6% over 30-day LIBOR, have terms of up to five years and are predominantly secured by first mortgage liens on the property. Additional yield enhancements may include origination fees, deferred interest, yield look-backs, and participating interests, which are equity interests in the borrower that share in a percentage of the underlying cash flows of the property. Borrowers typically use the proceeds of a conventional mortgage to repay a bridge loan.

***Mezzanine Financing.*** We offer mezzanine financing in the form of loans that are subordinate to a conventional first mortgage loan and senior to the borrower's equity in a transaction. Mezzanine financing may take the form of loans secured by pledges of ownership interests in entities that directly or indirectly control the real property or subordinated loans secured by second mortgage liens on the property. We may also require additional security such as personal guarantees, letters of credit and/or additional collateral unrelated to the property.

Our mezzanine loans typically range in size from \$1 million to \$10 million, have an interest rate range typically between 12% to 14% and have terms of up to ten years. Similar to our bridge loans, the yield on these investments may be enhanced by prepaid and deferred interest payments, yield look-backs and participating interests. We hold a majority of our mezzanine loans through subsidiaries of our operating partnership that are pass-through entities for tax purposes.

***Junior Participation Financing.*** We offer junior participation financing in the form of a junior participating interest in the senior debt. Junior participation financings have the same obligations, collateral and borrower as the senior debt. The junior participation interest is subordinated to the senior debt by virtue of a contractual agreement between the senior debt lender and the junior participating interest lender.

Our junior participation loans typically range in size from \$1 million to \$10 million, have an interest rate range typically between 12% to 14% and have terms of up to ten years. Similar to our bridge loans, the yield on these investments may be enhanced by prepaid and deferred interest payments, yield look-backs and participating interests.

***Preferred Equity Investments.*** We provide financing by making preferred equity investments in entities that directly or indirectly own real property. In cases where the terms of a first mortgage prohibit additional liens on the ownership entity, investments structured as preferred equity in the entity owning the property serve as viable financing substitutes. With preferred equity investments, we typically become a member in the ownership entity.

Our preferred equity investments typically range in size from \$1 million to \$10 million, have an interest rate range typically between 12% to 14% and have terms of up to ten years. Similar to our bridge loans, the yield on these investments may be enhanced by prepaid and deferred interest payments, yield look-backs and participating interests.

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**Structured Transactions.** We also periodically invest in structured transactions, which are primarily comprised of joint ventures formed to acquire, develop and/or sell real estate related assets. These joint ventures are generally not majority owned or controlled by us and are primarily accounted for under the equity method of accounting.

Through our Agency Business, we focus primarily on the following investment types:

**GSE and HUD Agency Lending.** We are one of 25 approved lenders that participate in Fannie Mae's DUS program and one of 22 lenders approved as a Freddie Mac Multifamily Conventional Loan lender for multifamily, manufactured, student, affordable and certain seniors housing properties, one of 11 participants in the Freddie Mac SBL program and an approved HUD MAP and LEAN lender providing construction permanent loans to developers and owners of multifamily housing, affordable housing, seniors housing and healthcare facilities. Our Agency Business underwrites, originates, sells and services multifamily mortgage loans across the U.S. through these programs and also originates and sells loans through the conduit markets. Our focus is primarily on small balance loans with an average loan size of approximately \$5.0 million. We retain the servicing rights and asset management responsibilities on substantially all loans made under the GSE programs.

**Other Investment Opportunities**

**Real Property.** We have, and may in the future, obtain real estate by foreclosure, through partial or full settlement of mortgage debt related to our loans, or as an investment opportunity. We may identify such assets and initiate an asset-specific plan to maximize the value of the investment, which can include appointing a third party property manager, renovation of the property, leasing or increasing the occupancy, or selling the asset. As such, these transactions may require the use of additional capital prior to the completion of the specific plan. In situations where we purchase real property as an investment opportunity, we typically analyze these transactions with the expectation that we will have the ability to sell the property within a one to three year time period for a significant return on invested capital.



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**Structured Business Portfolio Overview**

The following table sets forth information regarding our loan and investment portfolio as of December 31, 2016:

Type	Asset Class	Number	Unpaid Principal	Wtd. Avg. Pay Rate(1)	Wtd. Avg. Remaining Months to Maturity
Bridge Loans	Multifamily	105	\$ 1,370,447,204	5.95%	16.8
	Land	7	118,322,401	0.07%	7.9
	Office	4	64,833,574	7.32%	15.2
	Other	4	49,055,000	7.07%	28.9
		120	1,602,658,179	5.59%	16.4
Mezzanine Loans	Multifamily	7	26,233,265	10.43%	19.1
	Land	2	13,932,969	3.96%	7.7
	Office	1	13,000,000	11.00%	5.0
	Other	2	3,958,332	12.00%	89.3
		12	57,124,566	9.09%	17.9
Junior Participations	Office	2	62,256,582	4.50%	4.0
Preferred Equity	Multifamily	6	25,050,639	10.26%	15.5
	Hotel	1	34,750,000	3.56%	31.0
	Other	3	8,320,000	10.13%	18.8
		10	68,120,639	6.83%	23.8
Total		144	\$ 1,790,159,966	5.71%	16.3

(1)

"Weighted Average Pay Rate" is a weighted average, based on the unpaid principal balances of each loan in the portfolio, of our interest rate required to be paid monthly as stated in the individual loan agreements. Certain loans and investments that require an additional rate of interest "Accrual Rate" to be paid at maturity are not included in the weighted average pay rate as shown in the table.

The following tables set forth geographic and asset class information for our loan and investment portfolio as of December 31, 2016:

Geographic Location	Unpaid Principal	Percentage	Asset Class	Unpaid Principal	Percentage
New York	\$ 452,013,408	25.2%	Multifamily	\$ 1,421,731,108	79.4%
California	264,672,869	14.8%	Office	141,710,156	7.9%
Florida	257,981,986	14.4%	Land	137,255,369	7.7%
Texas	231,528,891	12.9%	Hotel	70,750,000	4.0%
Alabama	85,296,456	4.8%	Other	18,713,333	1.0%
Georgia	76,006,227	4.2%	Total	\$ 1,790,159,966	100%
Other(1)	422,660,129	23.7%			

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Total	\$ 1,790,159,966	100.0%
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(1)

No other individual state represented more than 4% of the total.

The overall yield on our loan and investment portfolio in 2016 was 6.38% on average assets of \$1.70 billion. This yield was computed by dividing the interest income earned during 2016 by the

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average assets during 2016. Our cost of funds in 2016 was 4.37% on average borrowings of \$1.32 billion. This cost of funds was computed by dividing the interest expense incurred during 2016 by the average borrowings during 2016.

We also own unconsolidated investments in equity affiliates totaling \$33.9 million, which consists primarily of a joint venture with our Manager formed to invest in a residential mortgage banking business.

**Agency Business Lending and Servicing Overview**

One of the Agency Business's primary sources of revenue is the gains and fees we recognize from the origination and sale of mortgage loans under the GSE programs. Loans originated under the GSE programs are generally sold within 60 days from the loan origination date. Our loan activity in 2016 (from the July 14, 2016 Acquisition date) was comprised of originations totaling \$2.15 billion and sales totaling \$1.49 billion, excluding \$418.2 million of sales on loans acquired as part of the Acquisition. Our gains and fees as a percentage of our loan sales volume or "sales margin," was 165 basis points for 2016.

The following tables set forth a summary of our servicing portfolio for the Agency Business by product and by geographic area as of December 31, 2016:

Product	Product Concentrations		Wtd. Avg. Servicing Fee Rate (basis points)	Percent of Total	Geographic Concentrations	
	Loan Count	UPB			State	UPB Percent of Total
Fannie Mae	2,114	\$ 11,181,152,400	53	83%	Texas	24%
					North	
Freddie Mac	635	1,953,244,541	22	14%	Carolina	9%
FHA	78	420,688,577	18	3%	California	8%
Total	2,827	\$ 13,555,085,518	48	100%	New York	8%
					Georgia	5%
					Florida	4%
					Other(1)	42%
					Total	100%

(1) No other individual state represented more than 4% of the total.

**Management Agreement**

Pursuant to the management agreement, our Manager employs certain of our executive officers and other staff who provide us with a variety of advisory and professional services vital to our operations, including Structured Business underwriting, accounting and treasury, compliance, marketing, information technology and human resources. The management agreement requires our Manager to provide a dedicated management team to perform these services, the members of which will devote as much of their time to our management as our independent directors reasonably deem necessary and appropriate, commensurate with our level of activity from time to time. The management agreement requires our Manager to provide such services in conformity with policies and investment guidelines that are approved and monitored by our Board of Directors. For performing the services under the management agreement, our Manager is eligible to receive a base management fee, incentive compensation and "success-based" compensation as described in Note 20 Agreements and Transactions with Related Parties. The management agreement was amended in connection with the Acquisition and we now have an option, expiring in July 2018, to purchase the existing management



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agreement and fully internalize our management structure for \$25.0 million (increasing to \$27.0 million after July 2017).

**Operations**

Prior to the Acquisition, our Manager was responsible for sourcing originations, providing underwriting services, processing approvals for all loans and other investments in our portfolio, as well as providing us with certain administrative loan servicing functions. As a result of the Acquisition, these services and employees associated with these services are now in-house. The following describes our lending and investment process for both our Structured Business and Agency Business.

**Origination.** We have a network of sales offices in California, Massachusetts, New Jersey, New York, Ohio, Oklahoma and Texas that staff approximately 20 loan originators who solicit property owners, developers and mortgage loan brokers. In some instances, the originators accept loan applications meeting our underwriting criteria from a select group of mortgage loan brokers. Once potential borrowers have been identified, we determine which of our financing products best meet the borrower's needs. Loan originators in every branch office are able to offer borrowers the full array of loan offerings and finance products for both the Structured and Agency businesses. After identifying a suitable product, we work with the borrower to prepare a loan application. Upon completion by the borrower, the application is forwarded to our underwriters for due diligence.

**Underwriting and Risk Management.** Our underwriters perform due diligence on all proposed transactions prior to approval and commitment using several tools to manage and mitigate potential loan losses and risk sharing exposure. The underwriters analyze each loan application in accordance with the guidelines set forth below to determine the loan's conformity with the guidelines. Key factors considered in credit decisions include, but are not limited to, debt service coverage, loan to value ratios and property, financial and operating performance. In general, our underwriting guidelines require it to evaluate the following:

The borrower and each person directing a borrowing entity's activities (a "key principal"), including a review of their experience, credit, operating, bankruptcy and foreclosure history;

The historic and current property revenues and expenses;

The potential for near-term revenue growth and opportunity for expense reduction and increased operating efficiencies;

The property's location, its attributes and competitive position within its market;

The proposed ownership structure, financial strength and real estate experience of the borrower and property management;

Third party appraisal, environmental flood certification, zoning and engineering studies;

Market assessment, including property inspection, review of tenant lease files, surveys of property comparables and an analysis of area economic and demographic trends;

Review of an acceptable mortgagee's title policy and an "as built" survey;

Construction quality of the property to determine future maintenance and capital expenditure requirements;

The requirements for any reserves, including those for immediate repairs or rehabilitation, replacement reserves, tenant improvement and leasing commission costs, real estate taxes and property casualty and liability insurance; and

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For any application for one of our Agency products, we will underwrite the loan to the relevant agency's guidelines.

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With respect to our Fannie Mae loans, we maintain concentration limits to further mitigate risk. Geographic concentration of such loans is limited based on regional employment concentration and trends, and we limit the aggregate amount of such loans subject to full risk-sharing for any one borrower and elect to use modified risk-sharing for such loans of more than \$23.0 million in accordance with Fannie Mae requirements. We also rely heavily on loan surveillance and credit risk management. We have a dedicated group of employees whose sole function is to monitor and analyze loan performance from closing to payoff, with the primary goal of managing and mitigating risk within the Fannie Mae portfolio.

We continuously refine our underwriting criteria based upon actual loan portfolio experience and as market conditions and investor requirements evolve.

**Investment Approval Process.** We apply an established investment approval process to all loans and other investments proposed for our Structured Business portfolio before submitting each proposal for final approval. A written report is generated for every loan or other investment that is submitted to our credit committee for approval, which consists of our chief executive officer, chief credit officer and executive vice president of structured finance. The report includes a description of the prospective borrower and any guarantors, the collateral and the proposed use of investment proceeds, as well as borrower and property financial statements and analysis. The report also includes an analysis of borrower liquidity, net worth, cash investment, income, credit history and operating experience. All transactions require the approval of a majority of the members of our credit committee. Following the approval of a transaction, our underwriting and servicing departments, together with our asset management group, assure that all loan approval terms have been satisfied and conform with lending requirements established for that particular transaction.

Our loan approval process for the Agency Business requires the submission of a detailed loan package in accordance with our underwriting checklist to our agency loan committee for approval. Our agency loan committee consists of multiple members of our senior and executive management teams, including our chief underwriter for the Agency Business and its chief operating officer. All transactions require the approval of up to four members, depending on the size of the loan. In addition, we are required to submit a completed loan underwriting package to Freddie Mac and HUD for approval prior to origination.

**Servicing.** We service all loans and investments through our internal servicing operations. We service an expanding portfolio, consisting of 2,827 loans with outstanding balances of \$13.56 billion at December 31, 2016 through the loan servicing department in Depew, New York. Our loan servicing operations are designed to provide prompt customer service and accurate and timely information for account follow up, financial reporting and management review. Following the funding of an approved loan, all pertinent loan data is entered into our data processing system, which provides monthly billing statements, tracks payment performance and processes contractual interest rate adjustments on variable rate loans. The servicing group works closely with our asset management group to ensure the appropriate level of customer service and monitoring of loans.

For most loans serviced under the Fannie Mae DUS program, we are required to advance, in the event of a borrower failing to pay, the principal and interest payments and tax and insurance escrow amounts associated with a loan for four months. We are reimbursed by Fannie Mae for these advances, which may be used to offset any losses incurred under our risk-sharing obligations once the loan and the related loss share is settled.

Under the HUD program, we are obligated to advance tax and insurance escrow amounts and principal and interest payments on the Ginnie Mae securities until the Ginnie Mae security is fully paid. In the event of a default on a HUD-insured loan, we can elect to assign the loan to HUD and file a mortgage insurance claim. HUD will reimburse approximately 99% of any losses of principal and interest on the loan and Ginnie Mae will reimburse substantially all of the remaining losses.

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**Asset Management.** Effective asset and portfolio management is essential to maximize the performance and value of a real estate investment. The asset management group customizes an asset management plan with the loan originators and underwriters to track each investment from origination through disposition. This group monitors each investment's operating history, local economic trends and rental and occupancy rates and evaluates the underlying property's competitiveness within its market. This group assesses ongoing and potential operational and financial performance of each investment in order to evaluate and ultimately improve its operations and financial viability. The asset management group performs frequent onsite inspections, conducts meetings with borrowers and evaluates and participates in the budgeting process, financial and operational review and renovation plans of each underlying property. The asset management group also focuses on increasing the productivity of onsite property managers and leasing brokers. This group communicates the status of each transaction against its established asset management plan to senior management, in order to enhance and preserve capital, as well as to avoid litigation and potential exposure.

Timely and accurate identification of an investment's operational and financial issues and each borrower's objectives is essential to implementing an executable loan workout and restructuring process, if required. Since the existing property management may not have the requisite expertise to manage the workout process effectively, our asset management group determines the current operating and financial status of an asset or portfolio and performs a liquidity analysis of the property and ownership entity and then, if appropriate, identifies and evaluates alternatives to maximize the value of an investment.

**Operating Policies and Strategies**

**Investment Guidelines.** Our Board of Directors has adopted general guidelines for our investments and borrowings to the effect that: (1) no investment will be made that would cause us to fail to qualify as a REIT; (2) no investment will be made that would cause us to be regulated as an investment company under the Investment Company Act; (3) no more than 25% of our equity (including junior subordinated notes as equity), determined as of the date of such investment, will be invested in any single asset; (4) no single mezzanine loan or preferred equity investment will exceed \$75 million; (5) our Structured Business leverage (including junior subordinated notes as equity) will generally not exceed 80% of the UPB of our assets, in the aggregate; (6) we will not co-invest with our Manager or any of its affiliates unless such co-investment is otherwise in accordance with these guidelines and its terms are at least as favorable to us as to our Manager or the affiliate making such co-investment; and (7) no more than 15% of our gross assets may consist of mortgage-related securities. Any exceptions to the above general guidelines require the approval of our Board of Directors.

**Financing Policies.** We finance the acquisition of our structured finance investments primarily by borrowing against or "leveraging" our existing portfolio and using the proceeds to acquire additional mortgage assets. We expect to incur debt such that we will maintain an equity-to-assets ratio no less than 20% (including junior subordinated notes as equity), although the actual ratio may be lower from time to time depending on market conditions and other factors deemed relevant by our Manager. Our charter and bylaws do not limit the amount of indebtedness we can incur, and the Board of Directors has discretion to deviate from or change our indebtedness policy at any time, provided that we are in compliance with our bank covenants. However, we intend to maintain an adequate capital base to protect against various business environments in which our financing and hedging costs might exceed the interest income from our investments.

Our structured finance investments are financed primarily by collateralized loan obligations ("CLOs"), junior subordinated notes, senior unsecured notes, convertible debt instruments and through other financing facilities with institutional lenders. Although we expect that these will be the principal means of leveraging these investments, we may issue common stock, preferred stock or secured, unsecured or convertible notes of any maturity if it appears advantageous to do so.



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Our Agency Business finances loan originations with several committed and uncommitted warehouse credit facilities on a short-term basis, as these loans are generally transferred or sold within 60 days from the loan origination date.

**Credit Risk Management Policy.** We are exposed to various levels of credit risk depending on the nature of our underlying assets and the nature and level of credit enhancements supporting our assets. Our Manager, our chief credit officer, and our asset management group, reviews and monitors credit risk and other risks of loss associated with each investment. In addition, our Manager seeks to diversify our portfolio of assets to avoid undue geographic, issuer, industry and certain other types of concentrations. Our Board of Directors monitors the overall portfolio risk and reviews levels of provision for loss.

**Interest Rate Risk Management Policy.** To the extent that it is consistent with our election to qualify as a REIT, we generally follow an interest rate risk management policy intended to mitigate the negative effects of major interest rate changes. We minimize our interest rate risk from borrowings by attempting to structure the key terms of our borrowings to generally correspond to the interest rate terms of our assets.

We may enter into hedging transactions to protect our investment portfolio from interest rate fluctuations and other changes in market conditions. These transactions may include interest rate swaps, the purchase or sale of interest rate collars, caps or floors, options, mortgage derivatives and other hedging instruments. These instruments may be used to hedge as much of the interest rate risk as our Manager determines is in the best interest of our stockholders, given the cost of such hedges and the need to maintain our status as a REIT. In general, income from hedging transactions does not constitute qualifying income for purposes of the REIT gross income requirements. To the extent, however, that a hedging contract reduces interest rate risk on indebtedness incurred to acquire or carry real estate assets, any income that is derived from the hedging contract, would not give rise to non-qualifying income for purposes of the 75% or 95% gross income tests. Our Manager may elect to have us bear a level of interest rate risk that could otherwise be hedged when it believes, based on all relevant facts, that bearing such risk is advisable.

**Disposition Policies.** Our Manager evaluates the asset portfolio in our Structured Business on a regular basis to determine if it continues to satisfy our investment criteria. Subject to certain restrictions applicable to REITs, our Manager may cause us to sell our investments opportunistically and use the proceeds for debt reduction, additional acquisitions, or working capital purposes.

**Equity Capital Policies.** Subject to applicable law, our Board of Directors has the authority, without further stockholder approval, to issue additional authorized common stock and preferred stock or otherwise raise capital, including through the issuance of senior securities and convertible debt instruments, in any manner and on the terms and for the consideration it deems appropriate, including in exchange for property. We may in the future issue common stock in connection with acquisitions. We also may issue units of partnership interest in our operating partnership in connection with acquisitions of property. We may, under certain circumstances, repurchase our common stock in private transactions with our stockholders, if those purchases are approved by our Board of Directors.

**Conflicts of Interest Policies.** We, our executive officers, and our Manager face conflicts of interests because of our relationships with each other. Our Manager has approximately 36.6% of the voting interest in our stock as of December 31, 2016. Mr. Kaufman, our chairman and chief executive officer, is the chief executive officer of our Manager and beneficially owns approximately 92% of the outstanding membership interests of our Manager. Mr. Martello, one of our directors, is the chief operating officer of Arbor Management, LLC (the managing member of our Manager) and a trustee of two trusts that own minority membership interests in our Manager. Mr. Bishar, our secretary, is general counsel to our Manager. Mr. Elenio, our chief financial officer and treasurer, is the chief financial

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officer of our Manager. Each of Messrs. Kaufman, Martello, Bishar, and Elenio, as well as Mr. Weber, our executive vice president of structured finance, Mr. Kilgore, our executive vice president of structured securitization and Mr. Guzewicz, our chief credit officer, are members of our Manager's executive committee and, excluding Mr. Kaufman, own minority membership interests in our Manager.

We have implemented several policies, through board action and through the terms of our charter and our agreements with our Manager, to help address these conflicts of interest, including the following:

Our charter requires that a majority of our Board of Directors be independent directors and that only our independent directors make any determination on our behalf with respect to the relationships or transactions that present a conflict of interest for our directors or officers.

Our Board of Directors adopted a policy that decisions concerning our management agreement with our Manager, including termination, renewal and enforcement thereof or our participation in any transactions with our Manager or its affiliates outside of the management agreement, including our ability to purchase securities and mortgages or other assets from our Manager, or our ability to sell securities and assets to our Manager, must be reviewed and approved by a majority of our independent directors. Pursuant to the agreement giving us the option to purchase the management agreement through July 2018, the Special Committee of our Board, formed to negotiate the Acquisition of our Manager's Agency Business, has the authority to exercise the option.

Our management agreement provides that our determination to terminate the management agreement for cause, because the management fees are unfair to us, or because of a change in control of our Manager, will be made by a majority vote of our independent directors.

Our independent directors will periodically review the general investment standards established by our Manager under the management agreement.

Our management agreement provides that our Manager may not assign duties under the management agreement, except to certain affiliates of our Manager, without the approval of a majority of our independent directors.

Our management agreement provides that decisions to approve or reject investment opportunities rejected by our credit committee that our Manager or Mr. Kaufman wish to pursue will be made by a majority of our independent directors.

Our Board of Directors has approved the operating policies and the strategies set forth above. Our Board of Directors has the power to modify or waive these policies and strategies, or amend our agreements with our Manager, without the consent of our stockholders to the extent that the Board of Directors determines that such modification or waiver is in the best interest of our stockholders. Among other factors, developments in the market that either affects the policies and strategies mentioned herein or that change our assessment of the market may cause our Board of Directors to revise its policies and strategies. However, if such modification or waiver involves the relationship of, or a transaction between us, and our Manager, the approval of a majority of our independent directors is also required. We may not, however, amend our charter to change the requirement that a majority of our board consists of independent directors or the requirement that our independent directors approve related party transactions without the approval of two thirds of the votes entitled to be cast by our stockholders.

**Federal and State Regulation of Commercial Real Estate Lending Activities**

Our multifamily and commercial real estate lending, servicing and asset management businesses are subject, in certain instances, to supervision and regulation by federal and state governmental

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authorities in the U.S. In addition, these businesses may be subject to various laws and judicial and administrative decisions imposing various requirements and restrictions, which, among other things, regulate lending activities, regulate conduct with borrowers, establish maximum interest rates, finance charges and other charges, require disclosures to borrowers and prohibit illegal discrimination. Although many states do not regulate commercial finance, certain states impose limitations on interest rates, as well as other charges on certain collection practices and creditor remedies. Some states also require licensing of lenders, loan brokers and loan servicers and adequate disclosure of certain contract terms. We are required to comply with certain provisions of, among other statutes and regulations, the USA PATRIOT Act, regulations promulgated by the U.S. Department of the Treasury's Office of Foreign Asset Control and other federal and state securities laws and regulations. These legal and regulatory requirements that apply to us are subject to change from time to time and may become more restrictive, making compliance with applicable requirements more difficult or expensive or otherwise restrict our ability to conduct its business in the manner that it is now conducted.

**Compliance with Federal, State and Local Environmental Laws**

Properties that we may acquire directly or indirectly through partnerships, and the properties underlying our structured finance investments and mortgage-related securities, are subject to various federal, state and local environmental laws, ordinances and regulations. Under these laws, ordinances and regulations, a current or previous owner of real estate (including, in certain circumstances, a secured lender that acquires ownership or control of a property) may become liable for the costs of removal or remediation of certain hazardous or toxic substances or petroleum product releases at, on, under or in its property. These laws typically impose cleanup responsibility and liability without regard to whether the owner or control party knew of or was responsible for the release or presence of the hazardous or toxic substances. The costs of investigation, remediation or removal of these substances may be substantial and could exceed the value of the property. An owner or control party of a site may be subject to common law claims by third parties based on damages and costs resulting from environmental contamination emanating from a site. Certain environmental laws also impose liability in connection with the handling of or exposure to materials containing asbestos. These laws allow third parties to seek recovery from owners of real properties for personal injuries associated with materials containing asbestos. Our operating costs and the values of these assets may be adversely affected by the obligation to pay for the cost of complying with existing environmental laws, ordinances and regulations, as well as the cost of complying with future legislation, and our income and ability to make distributions to our stockholders could be affected adversely by the existence of an environmental liability with respect to properties we may acquire. We will endeavor to ensure that these properties are in compliance in all material respects with all federal, state and local laws, ordinances and regulations regarding hazardous or toxic substances or petroleum products.

**Requirements of the GSEs and HUD**

To maintain our status as an approved lender for Fannie Mae and Freddie Mac and as a HUD-approved mortgagee and issuer of Ginnie Mae securities, we are required to meet and maintain various eligibility criteria from time to time established by these entities, such as minimum net worth, operational liquidity and collateral requirements and compliance with reporting requirements. We are required to originate loans and perform our loan servicing functions in accordance with the applicable program requirements and guidelines from time to time established by these agencies. If we fail to comply with the requirements of any of these programs, the agencies may terminate or withdraw our licenses and approvals to participate in the GSE programs. In addition, the agencies have the authority under their guidelines to terminate a lender's authority to sell loans to it and service their loans. The loss of one or more of these approvals would have a material adverse impact on our operations and could result in further disqualification with other counterparties.

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**Competition**

We face significant competition across our business, including, but not limited to, other mortgage REITs, specialty finance companies, savings and loan associations, banks, mortgage bankers, insurance companies, mutual funds, institutional investors, investment banking firms, other lenders, governmental bodies and other entities, some of which may have greater name recognition, financial resources and lower costs of capital available to them. In addition, there are numerous institutions with asset acquisition objectives similar to ours, and others may be organized in the future which may increase competition. Competitive variables include market presence and visibility, size of loans offered and underwriting standards. To the extent that a competitor is willing to risk larger amounts of capital in a particular transaction or to employ more liberal underwriting standards when evaluating potential loans, our origination volume and profit margins for our investment portfolio could be impacted. Our competitors may also be willing to accept lower returns on their investments and may succeed in buying the assets that we have targeted for acquisition.

We compete on the basis of quality of service, relationships, loan structure, terms, pricing and industry experience, including the knowledge of local and national commercial real estate market conditions, loan product expertise and the ability to analyze and manage credit risk. Our competitors also seek to compete aggressively on the basis of these factors and our success depends on the ability to offer attractive loan products, provide superior service, demonstrate its industry knowledge and experience, maintain and capitalize on relationships with investors, borrowers and key loan correspondents and remain competitive in pricing. In addition, future changes in laws, regulations and GSE program requirements, and consolidation in the commercial real estate finance market could lead to the entry of more competitors, or enhance the competitive strength of our existing competitors.

Although management believes that we are well positioned to continue to compete effectively in each facet of our business, there can be no assurance that we will do so or that we will not encounter increased competition in the future that could limit our ability to compete effectively.

**Employees**

At December 31, 2016, we employed 288 individuals. In addition, there are approximately 100 individuals employed by our Manager who, through the management agreement, allocate a portion of their time to us. None of our employees or our Manager's employees are represented by a union or subject to a collective bargaining agreement, and we never experienced a work stoppage.

**Corporate Governance and Internet Address**

Our internet address is [www.arborrealtytrust.com](http://www.arborrealtytrust.com). All of our filings with the Securities and Exchange Commission ("SEC") are made available free of charge through our website, including this report, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to such reports, if any, as filed with the SEC as soon as reasonably practicable after such filing. Our website also contains our code of business conduct and ethics, code of ethics for chief executive and senior financial officers, corporate governance guidelines, stockholder communications with the Board of Directors, and the charters of the committees of our Board of Directors. No information contained in or linked to our website is incorporated by reference in this report.

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**Item 1A. Risk Factors**

Our business is subject to various risks, including the risks listed below. If any of these risks actually occur, our business, financial condition and results of operations could be materially adversely affected and the value of our common stock could decline. The below listed risk factors should not be considered an all inclusive list. New risk factors emerge periodically and we cannot guarantee that the factors described below list all risks that may become material to us at any later time. Some of the risk factors discussed below may have different impacts on the Structured Business and the Agency Business.

**Risks Related to Our Business**

*An economic slowdown, a lengthy or severe recession, or declining real estate values could harm our operations.*

We believe the risks associated with our business are more severe during periods of economic downturn if these periods are accompanied by declining real estate values. Declining real estate values would likely limit our new mortgage loan originations, since borrowers often use increases in the value of their existing properties to support the purchase or investment in additional properties. Borrowers may also be less able to pay principal and interest on our loans if the real estate economy weakens. Declining real estate values also significantly increase the likelihood that we will incur losses on our loans in the event of default because the value of our collateral may be insufficient to cover our cost on the loan. Any sustained period of increased payment delinquencies, foreclosures or losses could adversely affect both our net interest income from loans in our portfolio as well as our ability to originate, sell and securitize loans, which would significantly harm our results of operations, financial condition, business prospects and our ability to make distributions to the stockholders.

*Prolonged disruptions in the financial markets could affect our ability to obtain financing on reasonable terms and have other adverse effects on us and the market price of our common stock.*

Commercial real estate is particularly adversely affected by a prolonged economic downturn and liquidity crisis, which occurred in 2007 through 2010. These circumstances materially impact liquidity in the financial markets and result in the scarcity of certain types of financing, and, in certain cases, make certain financing terms less attractive. If economic or market conditions deteriorate, and these adverse conditions return, lending institutions may be forced to exit markets such as repurchase lending, become insolvent, further tighten their lending standards or increase the amount of equity capital required to obtain financing, and in such event, could make it more difficult for us to obtain financing on favorable terms or at all. Our profitability will be adversely affected if we are unable to obtain cost-effective financing for our investments. In addition, these factors may make it more difficult for our borrowers to repay our loans as they may experience difficulties in selling assets, increased costs of financing or obtaining financing at all. These events may also make it more difficult or unlikely for us to raise capital through the issuance of our common stock or preferred stock. These disruptions in the financial markets also may have a material adverse effect on the market value of our common stock and other adverse effects on us.

*Increases in loan loss reserves and other impairments are likely if economic conditions deteriorate.*

A decline in economic conditions could negatively impact the credit quality of our loan and investment portfolio and could cause us to experience increases in loan loss reserves, potential defaults and other asset impairment charges.

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***Loan loss reserves are particularly difficult to estimate in a turbulent economic environment.***

We perform an evaluation of our loans on a quarterly basis to determine whether an impairment is necessary and adequate to absorb probable losses. The valuation process for our loan and investment portfolio requires us to make certain estimates and judgments, which are particularly difficult to determine during a period in which the availability of commercial real estate credit is limited and commercial real estate transactions have decreased. Our estimates and judgments are based on a number of factors, including projected cash flows from the collateral securing our commercial real estate loans, loan structure, including the availability of reserves and recourse guarantees, likelihood of repayment in full at loan maturity, potential for a refinancing market coming back to commercial real estate in the future and expected market discount rates for varying property types. If our estimates and judgments are not correct, our results of operations and financial condition could be severely impacted.

***Loan repayments are less likely in a volatile market environment.***

In a market in which liquidity is essential to our business, particularly our Structured Business, loan repayments have been a significant source of liquidity for us. If borrowers are unable to refinance loans at maturity, the loans could go into default and the liquidity that we would receive from such repayments will not be available. Furthermore, in the event the commercial real estate finance market deteriorates, borrowers that are performing on their loans will most likely extend such loans if they have that right, which will further delay our ability to access liquidity through repayments.

***We may not be able to access the debt or equity capital markets on favorable terms, or at all, for additional liquidity, which could adversely affect our business, financial condition and operating results.***

Additional liquidity, future equity or debt financing may not be available on terms that are favorable to us, or at all. Our ability to access additional debt and equity capital depends on various conditions in these markets, which are beyond our control. If we are able to complete future equity offerings, they could be dilutive to our existing stockholders or could result in the issuance of securities that have rights, preferences and privileges that are senior to those of our other securities. Our inability to obtain adequate capital could have a material adverse effect on our business, financial condition, liquidity and operating results.

***We may be unable to invest excess equity capital on acceptable terms or at all, which would adversely affect our operating results.***

We may not be able to identify investments that meet our investment criteria and we may not be successful in closing the investments that we identify. In addition, the investments that we acquire with our equity capital may not produce a return on capital. There can be no assurance that we will be able to identify attractive opportunities to invest our equity capital, which would adversely affect our results of operations.

***Changes in market conditions could adversely affect the market price of our stock.***

As with other publicly traded equity securities, the value of our stock depends on various market conditions which may change from time to time. Among the market conditions that may affect the value of our stock are the following:

The general reputation of REITs and the attractiveness of our equity securities in comparison to other equity securities, including securities issued by other real estate-based companies;

Our financial performance; and

General stock and bond market conditions.

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The market value of our stock is based primarily upon the market's perception of our growth potential and our current and potential future earnings and dividends. Consequently, our stock may trade at prices that are higher or lower than our book value per share of stock. If our future earnings or dividends are less than expected, it is likely that the market price of our stock will diminish.

***A declining portfolio could adversely affect the returns from our investments.***

Conditions in the capital markets could lead to a reduction in our loan and investment portfolio. If we do not have the opportunity to originate quality investments to replace the reductions in our portfolio, this reduction will likely result in reduced returns from our investments.

***Rising interest rates could have an adverse effect on a borrower's ability to make interest payments.***

A significant portion of our loans and borrowings in our Structured Business are variable-rate instruments based on LIBOR. However, a portion of our loan portfolio is fixed-rate or is subject to interest rate floors that limit the impact of a decrease in interest rates. In addition, certain of our borrowings are also fixed rate or are subject to interest rate swaps that hedge our exposure to interest rate risk on fixed rate loans financed with variable rate debt. As a result, the impact of a change in interest rates may be different on our interest income than it is on our interest expense. In the event of a significant rising interest rate environment and/or economic downturn, defaults could increase and result in credit losses to us, which could adversely affect our liquidity and operating results. Further, such delinquencies or defaults could have an adverse effect on the spreads between interest-earning assets and interest-bearing liabilities.

***We depend on key personnel with long standing business relationships, the loss of whom could threaten our ability to operate our business successfully.***

Our future success depends, to a significant extent, upon the continued services of key personnel. In particular, the mortgage lending experience of Mr. Kaufman and Mr. Weber and the extent and nature of relationships they have developed with developers and owners of multifamily and commercial properties and other financial institutions are critical to our success. We cannot assure their continued employment as our officers. In addition, we remain dependent on the services of our Manager and its employees. The loss of services of one or more members of our or our Manager's management team could harm our business and our prospects.

***The real estate investment business is highly competitive. Our success depends on our ability to compete with other providers of capital for real estate investments.***

Our business is highly competitive. Competition may cause us to accept economic or structural features in our investments, particularly in our Structured Business, that we would not have otherwise accepted and it may cause us to search for investments in markets outside of our traditional product expertise. We compete for attractive investments with traditional lending sources, such as insurance companies and banks, as well as other REITs, specialty finance companies and private equity vehicles with similar investment objectives, which may make it more difficult for us to consummate our target investments. Many of our competitors have greater financial resources and lower costs of capital than we do, which provides them with greater operating flexibility and a competitive advantage relative to us.

***We may not achieve our targeted rate of return on our investments.***

We originate or acquire investments based on our estimates or projections of overall rates of return on such investments, which in turn are based upon, among other considerations, assumptions regarding the performance of assets, the amount and terms of available financing to obtain desired

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leverage and the manner and timing of dispositions, including possible asset recovery and remediation strategies, all of which are subject to significant uncertainty. In addition, events or conditions that we have not anticipated may occur and may have a significant effect on the actual rate of return received on an investment.

As we acquire or originate investments, whether as new additions or as replacements for maturing investments, there can be no assurance that we will be able to produce rates of return comparable to returns on our previous or existing investments.

***Our due diligence may not reveal all of a borrower's liabilities and may not reveal other weaknesses in its business.***

Before making a loan to a borrower, we assess the strength and skills of such entity's management and other factors that we believe are material to the performance of the investment. In performing our due diligence, we rely on the resources available to us and, in some cases, an investigation by third parties. This process is particularly important and subjective with respect to newly organized entities because there may be little or no information publicly available about the entities. There can be no assurance that our due diligence processes will uncover all relevant facts or that any investment will be successful.

***We invest in junior participation loans which may be subject to additional risks relating to the privately negotiated structure and terms of the transaction, which may result in losses to us.***

In our Structured Business, we invest in junior participation loans which are mortgage loans typically (i) secured by a first mortgage on a single commercial property or group of related properties and (ii) subordinated to a senior note secured by the same first mortgage on the same collateral. As a result, if a borrower defaults, there may not be sufficient funds remaining for the junior participation loan after payment is made to the senior note holder. Since each transaction is privately negotiated, junior participation loans can vary in their structural characteristics and risks. For example, the rights of holders of junior participation loans to control the process following a borrower default may be limited in certain investments. We cannot predict the terms of each junior participation investment. A junior participation may not be liquid and, consequently, we may be unable to dispose of underperforming or non-performing investments. The higher risks associated with a subordinate position in any investment we make could subject us to increased risk of losses.

***We invest in mezzanine loans which are subject to a greater risk of loss than loans with a first priority lien on the underlying real estate.***

In our Structured Business, we invest in mezzanine loans that take the form of subordinated loans secured by second mortgages on the underlying property or loans secured by a pledge of the ownership interests of either the entity owning the property or a pledge of the ownership interests of the entity that owns the interest in the entity owning the property. These types of investments involve a higher degree of risk than long-term senior mortgage lending secured by income producing real property because the investment may become unsecured as a result of foreclosure by the senior lender. In the event of a bankruptcy of the entity providing the pledge of its ownership interests as security, we may not have full recourse to the assets of such entity, or the assets of the entity may not be sufficient to satisfy our mezzanine loan. If a borrower defaults on our mezzanine loan or debt senior to our loan, or in the event of a borrower bankruptcy, our mezzanine loan will be satisfied only after the senior debt. As a result, we may not recover some or all of our investment. In addition, mezzanine loans may have higher loan to value ratios than conventional mortgage loans, resulting in less equity in the property and increasing the risk of loss of principal.



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***Preferred equity investments involve a greater risk of loss than traditional debt financing.***

In our Structured Business, we invest in preferred equity investments, which involve a higher degree of risk than traditional debt financing due to a variety of factors, including that such investments are subordinate to other loans and are not secured by property underlying the investment. Furthermore, should the issuer default on our investment, we would only be able to proceed against the partnership in which we have an interest, and not the property underlying our investment. As a result, we may not recover some or all of our investment.

***We invest in multifamily and commercial real estate loans, which may involve a greater risk of loss than single family real estate loans.***

Our investments include multifamily and commercial real estate loans that involve a higher degree of risk than single family residential lending because of a variety of factors, including generally larger loan balances, dependency for repayment on successful operation of the mortgaged property and tenant businesses operating therein, and loan terms that include amortization schedules longer than the stated maturity and provide for balloon payments at stated maturity rather than periodic principal payments. In addition, the value of commercial real estate can be affected significantly by the supply and demand in the market for that type of property.

***Volatility of values of multifamily and commercial properties may adversely affect our loans and investments.***

Multifamily and commercial property values and net operating income derived from such properties are subject to volatility and may be affected adversely by a number of factors, including, but not limited to, events such as natural disasters, including hurricanes and earthquakes, acts of war and/or terrorism and others that may cause unanticipated and uninsured performance declines and/or losses to us or the owners and operators of the real estate securing our investment; national, regional and local economic conditions, such as what we have experienced in recent years (which may be adversely affected by industry slowdowns and other factors); local real estate conditions (such as an oversupply of housing, retail, industrial, office or other commercial space); changes or continued weakness in specific industry segments; construction quality, construction cost, age and design; demographic factors; retroactive changes to building or similar codes; and increases in operating expenses (such as energy costs). In the event a property's net operating income decreases, a borrower may have difficulty repaying our loan, which could result in losses to us. In addition, decreases in property values reduce the value of the collateral and the potential proceeds available to a borrower to repay our loans, which could also cause us to suffer losses.

***Many of our commercial real estate loans are funded with interest reserves and our borrowers may be unable to replenish those interest reserves once they run out.***

Given the transitional nature of many of our commercial real estate loans in our Structured Business portfolio, we often require borrowers to post reserves to cover interest and operating expenses until the property cash flows are projected to increase sufficiently to cover debt service costs. We also generally require the borrower to replenish reserves if they become depleted due to underperformance or if the borrower wants to exercise extension options under the loan. Despite low interest rates, revenues on the properties underlying any commercial real estate loan investments would decrease in an economic downturn, making it more difficult for borrowers to meet their payment obligations to us. In the future, some borrowers may continue to have difficulty servicing our debt and will not have sufficient capital to replenish reserves, which could have a significant impact on our operating results and cash flows.

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***We may not have control over certain of our loans and investments.***

Our ability to manage our structured portfolio of loans and investments may be limited by the form in which they are made. In certain situations, we may acquire investments subject to rights of senior classes and servicers under inter-creditor or servicing agreements; acquire only a participation in an underlying investment; co-invest with third parties through partnerships, joint ventures or other entities, thereby acquiring non-controlling interests; or rely on independent third party management or strategic partners with respect to the management of an asset. Therefore, we may not be able to exercise control over the loan or investment. Such financial assets may involve risks not present in investments where senior creditors, servicers or third party controlling investors are not involved. Our rights to control the process following a borrower default may be subject to the rights of senior creditors or servicers whose interests may not be aligned with ours. A third party partner may have financial difficulties resulting in a negative impact on such assets and may have economic or business interests or goals which are inconsistent with ours. In addition, we may, in certain circumstances, be liable for the actions of our third party partners.

***Real estate property may fail to perform as expected.***

We may obtain new real estate properties through foreclosure proceedings or investment. Such newly obtained properties may not perform as expected and may subject us to unknown liabilities relating to such properties for clean-up of undisclosed environmental contamination or claims by tenants, vendors or other persons against the former owners of the properties. Inaccurate assumptions regarding future rental or occupancy rates could result in overly optimistic estimates of future revenues. In addition, future operating expenses or the costs necessary to bring an obtained property up to standards established for its intended market position may be underestimated.

***The adverse resolution of a lawsuit could have a material adverse effect on our financial condition and results of operations.***

The adverse resolution of litigation for which we have been named as a defendant could have a material adverse effect on our financial condition and results of operations. See Note 16 Commitments and Contingencies for information on our current litigation.

***The impact of any future terrorist attacks and the availability of terrorism insurance expose us to certain risks.***

Any future terrorist attacks, the anticipation of any such attacks, and the consequences of any military or other response by the United States ("U.S.") and its allies may have an adverse impact on the U.S. financial markets and the economy in general. We cannot predict the severity of the effect that any such future events would have on the U.S. financial markets, including the real estate capital markets, the economy or our business. Any future terrorist attacks could adversely affect the credit quality of some of our loans and investments. Some of our loans and investments will be more susceptible to such adverse effects than others. We may suffer losses as a result of the adverse impact of any future terrorist attacks and these losses may adversely impact our results of operations.

In addition, the enactment of the Terrorism Risk Insurance Act of 2002, or the TRIA, and the subsequent enactment of the Terrorism Risk Insurance Program Reauthorization Act of 2007, requires insurers to make terrorism insurance available under their property and casualty insurance policies in order to receive federal compensation under TRIA for insured losses. However, this legislation does not regulate the pricing of such insurance. The absence of affordable insurance coverage may adversely affect the general real estate lending market, lending volume and the market's overall liquidity and may reduce the number of suitable investment opportunities available to us and the pace at which we are able to make investments. If the properties that we invest in are unable to obtain affordable insurance

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coverage, the value of those investments could decline and in the event of an uninsured loss, we could lose all or a portion of our investment.

***Failure to maintain an exemption from regulation as an investment company under the Investment Company Act would adversely affect our results of operations.***

We believe that we conduct, and we intend to conduct our business in a manner that allows us to avoid being regulated as an investment company under the Investment Company Act. Pursuant to Section 3(c)(5)(C) of the Investment Company Act, entities that are primarily engaged in the business of purchasing or otherwise acquiring "mortgages and other liens on and interests in real estate" are currently exempted from regulation thereunder. The staff of the SEC has provided guidance on the availability of this exemption. Specifically, the staff's position generally requires a company to maintain at least 55% of its assets directly in "qualifying real estate interests." To constitute as a qualifying real estate interest under this 55% test, an interest in real estate must meet various criteria. Loans that are secured by equity interests in entities that directly or indirectly own the underlying real property, rather than a mortgage on the underlying property itself, and ownership of equity interests in real property owners may not qualify for purposes of the 55% test depending on the type of entity. Mortgage-related securities that do not represent all of the certificates issued with respect to an underlying pool of mortgages may also not qualify for purposes of the 55% test. Therefore, our ownership of these types of loans and equity interests may be limited by the provisions of the Investment Company Act. There can be no assurance that the laws and regulations governing the Investment Company Act status of REITs, including the guidance of the Division of Investment Management of the SEC regarding this exemption, will not change in a manner that adversely affects our operations. To the extent that we do not comply with the 55% test, another exemption or exclusion from registration as an investment company under that Act or other interpretations under the Investment Company Act, or if the SEC no longer permits our exemption, we may be deemed to be an investment company. If we fail to maintain an exemption or other exclusion from registration as an investment company we could, among other things, be required either (a) to substantially change the manner in which we conduct our operations to avoid being required to register as an investment company or (b) to register as an investment company, either of which could have an adverse effect on us and the market price of our common stock. If we were required to register as an investment company under that Act, we would become subject to substantial regulation with respect to our capital structure (including our ability to use leverage), management, operations, transactions with affiliated persons (as defined in the Investment Company Act), portfolio composition, including restrictions with respect to diversification and industry concentration and other matters.

***Our Manager and one of our subsidiaries are required to register under the Investment Advisers Act, and are subject to regulation under that Act.***

Our Manager and one of our subsidiaries are subject to the extensive regulation prescribed by the Investment Advisers Act. The SEC oversees activities as a registered investment adviser under this regulatory regime. A failure to comply with the obligations imposed by the Investment Advisers Act, including record-keeping, advertising and operating requirements, disclosure obligations and prohibitions on fraudulent activities, could result in fines, censure, suspensions of personnel or investing activities or other sanctions, including revocation of our registration as an investment adviser. The regulations under the Investment Advisers Act are designed primarily to protect investors and other clients, and are not designed to protect holders of our publicly traded stock. Even if a sanction imposed against our Manager or its personnel involves a small monetary amount, the adverse publicity related to such sanction could harm our reputation and our relationship with our investors and impede our ability to raise additional capital. In addition, compliance with the Investment Advisers Act may require us to incur additional costs, and these costs may be material.

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*The impact of any future laws, as well as amendments to current laws, may place restrictions on our business.*

Future legislation could impose additional financial obligations or restrictions with respect to our business. The past economic environment has placed an increased level of scrutiny on the financial services sector, which led to the signing of the Dodd-Frank Act in 2010. Many aspects of the Dodd-Frank Act are subject to rulemaking and will take effect over several years, making it difficult to anticipate the overall financial impact on us and, more generally, the financial services and mortgage industries. It is difficult to predict the exact nature of any future legislation and the extent to which such legislation, if any, will impact our business, financial condition, or results of operations.

*The effects of government regulation could negatively impact the market value of loans related to development projects.*

Loans related to development projects bear additional risk in that government regulation could impact the value of the project by limiting the development of the property. If the proper approvals for the completion of the project are not granted, the value of the collateral may be adversely affected which may negatively impact the value of the loan.

**Risks Related to Our Financing and Hedging Activities**

*We may not be able to access financing sources on favorable terms, or at all, which could adversely affect our ability to execute our business plan.*

We generally finance our Structured Business loans and investments through a variety of means, including credit facilities, senior unsecured notes, junior subordinated notes, CLOs and other structured financings. We generally finance our Agency Business loan originations, prior to sale to, or securitization by, an agency, through credit facilities provided by commercial banks. Our ability to execute this strategy depends on various conditions in the markets for financing in this manner that are beyond our control, including lack of liquidity and wider credit spreads, which we have seen over the past several years. If conditions deteriorate, we cannot assure that these sources are feasible as a means of financing as there can be no assurance that any existing agreements will be renewed or extended at expiration. If our strategy is not viable, we will have to find alternative forms of long-term and short-term financing as credit and repurchase facilities may not accommodate our needs. This could subject us to more recourse indebtedness and the risk that debt service on less efficient forms of financing would require a larger portion of our cash flows, thereby reducing cash available for distribution to our stockholders, funds available for operations as well as for future business opportunities.

*Credit facilities may contain restrictive covenants relating to our operations.*

Credit facilities may contain various financial covenants and restrictions, including minimum net worth, liquidity and debt-to-equity ratios. Other restrictive covenants contained in credit facility agreements may include covenants that prohibit affecting a change in control, disposing of or encumbering assets being financed, maximum debt balance requirements, and restrictions from making material amendments to underwriting guidelines without lender approval. While we actively manage our loan and investment portfolio, a weak economic environment will make maintaining compliance with future credit facilities' covenants more difficult. If we are not in compliance with any of these covenants, there can be no assurance that our lenders would waive or amend such non-compliance in the future and any such non-compliance could have a material adverse effect on us.

*We may not be able to obtain the level of leverage necessary to optimize our return on investment.*

In our Structured Business, our return on investment depends, in part, upon our ability to grow our portfolio of invested assets through the use of leverage at a cost of debt that is lower than the yield

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earned on our investments. We typically obtain leverage through the issuance of CLOs, credit agreements and other borrowings. Our future ability to obtain the necessary leverage on beneficial terms ultimately depends upon the quality of the portfolio assets that collateralize our indebtedness. Our failure to obtain and/or maintain leverage at desired levels or on attractive terms would have a material adverse effect on the performance of our Structured Business. Moreover, we may be dependent upon a few lenders to provide financing under credit agreements for our origination or acquisition of loans and investments and there can be no assurance that these agreements will be renewed or extended at expiration. Our ability to obtain financing through CLOs is subject to conditions in the debt capital markets which are impacted by factors beyond our control that may at times be adverse and reduce the level of investor demand for such securities.

***The credit facilities that we may use to finance our investments may require us to provide additional collateral.***

We may use credit facilities to finance investments in the future. If the market value of the loans or investments pledged or sold by us to a funding source decline in value, we may be required by the lending institution to provide additional collateral or pay down a portion of the funds advanced. We may not have the funds available to pay down such future debt, which could result in defaults. Posting additional collateral to support these potential credit facilities would reduce our liquidity and limit our ability to leverage our assets. In the event we do not have sufficient liquidity to meet such requirements, lending institutions can accelerate the indebtedness, increase interest rates and terminate our ability to borrow. Further, lenders may require us to maintain a certain amount of uninvested cash or set aside unlevered assets sufficient to maintain a specified liquidity position which would allow us to satisfy our collateral obligations. As a result, we may not be able to leverage our assets as fully as we would choose, which could reduce our return on assets. In the event that we are unable to meet these collateral obligations, our financial condition could deteriorate rapidly.

***Our use of leverage may create a mismatch with the duration and index of the investments that we are financing.***

We attempt to structure our leverage, particularly in our Structured Business, such that we minimize the difference between the term of our investments and the term of the leverage we use to finance the investment. In the event our leverage is for a shorter term than the financed investment, we may not be able to extend or find appropriate replacement leverage and that would have an adverse impact on our liquidity and our returns. In the event our leverage is for a longer term than the financed investment, we may not be able to repay such leverage or replace the financed investment with an optimal substitute or at all, which will negatively impact our desired leveraged returns.

We attempt to structure our leverage such that we minimize the difference between the index of our investments and the index of our leverage financing floating rate investments with floating rate leverage and fixed rate investments with fixed rate leverage. If such a product is not available to us from our lenders on reasonable terms, we may use hedging instruments to effectively create such a match. For example, in the case of fixed rate investments, we may finance such an investment with floating rate leverage, but effectively convert all or a portion of the leverage to fixed rate using hedging strategies. Our attempts to mitigate such risk are subject to factors outside of our control, such as the availability to us of favorable financing and hedging options, which is subject to a variety of factors, of which duration and term matching are only two such factors.

***We utilize a significant amount of debt to finance our portfolio, which may subject us to an increased risk of loss, adversely affecting the return on our investments and reducing cash available for distribution.***

We utilize a significant amount of debt to finance our operations, which may compound losses and reduce the cash available for distributions to our stockholders. We generally leverage our portfolio

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through the use of securitizations, including the issuance of CLOs, bank credit facilities, and other borrowings. The leverage we employ varies depending on the types of assets being financed, availability of funds, ability to obtain credit facilities, the loan-to-value and debt service coverage ratios of our assets, the yield on our assets, the targeted leveraged return we expect from our portfolio and our ability to meet ongoing covenants related to our asset mix and financial performance. Substantially all of our assets are pledged as collateral for our borrowings. In addition, we may acquire real estate property subject to debt obligations. The return on our investments and cash available for distribution to our stockholders may be reduced to the extent that changes in market conditions cause the cost of our financing to increase relative to the income that we can derive from the assets we acquire.

Our debt service payments reduce the net income available for distributions. Moreover, we may not be able to meet our debt service obligations and, to the extent we cannot, we risk the loss of some or all of our assets to foreclosure or sale to satisfy our debt obligations. Currently, neither our charter nor our bylaws impose any limitations on the extent to which we may leverage our assets.

***We may guarantee some of our leverage and contingent obligations.***

We may guarantee the performance of some of our obligations in the future, including but not limited to any repurchase agreements, derivative agreements, and unsecured indebtedness. Non-performance on such obligations may cause losses to us in excess of the capital we initially may invest/commit to under such obligations and there is no assurance that we will have sufficient capital to cover any such losses.

***We may not be able to acquire suitable investments for a CLO issuance, or we may not be able to issue CLOs on attractive terms, or at all, which may require us to utilize more costly financing for our investments.***

We have financed, and, if the opportunities exist in the future, we may continue to finance certain of our investments in our Structured Business through the issuance of CLOs. During the period we are acquiring investments for eventual long-term financing through CLOs, we have typically financed these investments through repurchase and credit agreements. We use these agreements to finance our acquisition of investments until we have accumulated a sufficient quantity of investments, at which time we may refinance them through a CLO securitization. As a result, we are subject to the risk that we will not be able to acquire a sufficient amount of eligible investments to maximize the efficiency of a CLO issuance. In addition, conditions in the debt capital markets may make the issuance of CLOs less attractive to us even when we do have a sufficient pool of collateral, or we may not be able to execute a CLO transaction on terms favorable to us or at all. If we are unable to issue a CLO to finance these investments, we may be required to utilize other forms of potentially less attractive financing.

***The use of CLO financings with over-collateralization and interest coverage requirements may have a negative impact on our cash flows.***

The terms of CLOs will generally provide that the principal amount of investments must exceed the principal balance of the related bonds by a certain amount and that interest income exceeds interest expense by a certain amount. Generally, CLO terms provide that, if certain delinquencies and/or losses or other factors cause a decline in collateral or cash flow levels, the cash flow otherwise payable on subordinated classes may be redirected to repay senior classes of CLOs until the issuer or the collateral is in compliance with the terms of the governing documents. Other tests (based on delinquency levels or other criteria) may restrict our ability to receive interest payments from assets pledged to secure CLOs. We cannot assure that the performance tests will be satisfied. If our investments fail to perform as anticipated, our over-collateralization, interest coverage or other credit enhancement expense associated with our CLO financings will increase. With respect to future CLOs we may issue, we cannot assure, in advance of completing negotiations with the rating agencies or other key transaction parties as to the actual terms of the delinquency tests, over-collateralization and interest

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coverage terms, cash flow release mechanisms or other significant factors upon which net income to us will be calculated. Failure to obtain favorable terms with regard to these matters may adversely affect the availability of net income to us.

***We may not be able to find suitable replacement investments for CLO reinvestment periods.***

CLOs have periods where principal proceeds received from assets securing the CLO can be reinvested for a defined period of time, commonly referred to as a reinvestment period. Our ability to find suitable investments during the reinvestment period that meet the criteria set forth in the CLO governing documents and by rating agencies may determine the success of our CLO investments. Our potential inability to find suitable investments may cause, among other things, lower returns, interest deficiencies, hyper-amortization of the senior CLO liabilities and may cause us to reduce the life of the CLO and accelerate the amortization of certain fees and expenses.

***We may be required to repurchase loans that we have sold or to indemnify holders of our CLOs.***

If any of the loans we originate or acquire and sell or securitize through CLOs do not comply with representations and warranties we make about certain characteristics of the loans, the borrowers and the underlying properties, we may be required to repurchase those loans or replace them with substitute loans. In addition, in the case of loans that we have sold instead of retained, we may be required to indemnify persons for losses or expenses incurred as a result of a breach of a representation or warranty. Repurchased loans typically require a significant allocation of working capital to carry on our books, and our ability to borrow against such assets is limited. Any significant repurchases or indemnification payments could adversely affect our financial condition and operating results.

***Our loans and investments may be subject to fluctuations in interest rates which may not be adequately protected, or protected at all, by our hedging strategies.***

Our current investment program for our Structured Business emphasizes loans with both floating and fixed interest rates. Floating rate investments earn interest at rates that adjust from time to time (typically monthly) based upon an index (typically LIBOR), allowing this portion of our portfolio to be insulated from changes in value due specifically to changes in interest rates. Fixed rate investments, however, do not have adjusting interest rates and, as prevailing interest rates change, the relative value of the fixed cash flows from these investments will cause potentially significant changes in value. The majority of our interest-earning assets and interest-bearing liabilities in our Structured Business have floating rates of interest. However, depending on market conditions, fixed rate assets may become a greater portion of our new loan originations. We may employ various hedging strategies to limit the effects of changes in interest rates (and in some cases credit spreads), including engaging in interest rate swaps, caps, floors and other interest rate derivative products. No strategy can completely insulate us from the risks associated with interest rate changes and there is a risk that they may provide no protection at all and potentially compound the impact of changes in interest rates. Hedging transactions involve certain additional risks such as counterparty risk, the legal enforceability of hedging contracts, the early repayment of hedged transactions and the risk that unanticipated and significant changes in interest rates may cause a significant loss of basis in the contract and a change in current period expense. We cannot make assurances that we will be able to enter into hedging transactions or that such hedging transactions will adequately protect us against the foregoing risks. In addition, cash flow hedges which are not perfectly correlated (and appropriately designated and documented as such) with a variable rate financing will impact our reported income as gains and losses on the ineffective portion of such hedges will be recorded on our statement of income.

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***Hedging instruments often are not guaranteed by an exchange or its clearing house and involve risks and costs.***

The cost of using hedging instruments increases as the period covered by the instrument lengthens and during periods of rising and volatile interest rates. We may increase our hedging activity and thus increase our hedging costs during periods when interest rates are volatile or rising and hedging costs have increased.

In addition, hedging instruments involve risk since they currently are often not guaranteed by an exchange or its clearing house. The enforceability of agreements underlying derivative transactions may depend on compliance with applicable statutory, commodity and other regulatory requirements and, depending on the identity of the counterparty, applicable international requirements. The business failure of a hedging counterparty with whom we enter into a hedging transaction will most likely result in a default. Default by a party with whom we enter into a hedging transaction may result in the loss of unrealized profits and force us to cover our resale commitments, if any, at the then current market price. Although generally we will seek to reserve the right to terminate our hedging positions, it may not always be possible to dispose of or close out a hedging position without the consent of the hedging counterparty, and we may not be able to enter into an offsetting contract to cover our risk. We cannot assure that a liquid secondary market will exist for hedging instruments purchased or sold, and we may be required to maintain a position until exercise or expiration, which could result in losses.

***We may enter into derivative contracts that could expose us to contingent liabilities in the future.***

Subject to maintaining our qualification as a REIT, part of our investment strategy involves entering into derivative contracts that could require us to fund cash payments in the future under certain circumstances (e.g., the early termination of the derivative agreement caused by an event of default or other early termination event, or the decision by a counterparty to request margin securities it is contractually owed under the terms of the derivative contract). The amount due would be equal to the unrealized loss of the open swap positions with the respective counterparty and could also include other fees and charges. These economic losses will be reflected in our financial results of operations, and our ability to fund these obligations will depend on the liquidity of our assets and access to capital at the time, and the need to fund these obligations could adversely impact our financial condition.

***We are subject to certain counterparty risks related to our derivative contracts.***

We periodically hedge a portion of our interest rate risk by entering into derivative financial instrument contracts. In a global credit crisis, there is a risk that counterparties could fail, shut down, file for bankruptcy or be unable to pay out contracts. The failure of a counterparty that holds collateral we post in connection with certain interest rate swap agreements could result in the loss of such collateral.

***The loss of or changes in our Agency Business's relationships with the GSEs, United States Department of HUD and institutional investors would adversely affect our ability to originate commercial real estate loans through GSE and HUD programs, which would materially and adversely affect us.***

Currently, the Agency Business originates nearly all of its loans for sale through GSE or HUD programs. The Agency Business is approved as a Fannie Mae DUS lender nationwide, a Freddie Mac Program Plus lender in New York, New Jersey and Connecticut, a Freddie Mac Targeted Affordable Housing, Manufactured Housing Community, Seniors Housing and Small Balance Loan Lender nationwide, a HUD MAP and LEAN lender nationwide, and a Ginnie Mae issuer. Our status as an approved lender affords the Agency Business a number of advantages and may be terminated by the applicable GSE or HUD at any time. The loss of such status would, or changes in its relationships could, prevent us from being able to originate commercial real estate loans for sale through the



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particular GSE or HUD, which would materially and adversely affect us. It could also result in a loss of similar approvals from other GSEs or HUD.

We also originate and sell loans to investment banks through the CMBS conduit markets. If these investment banks discontinue their relationship with us and replacement investors cannot be found on a timely basis, we could be adversely affected.

***A change to the conservatorship of Fannie Mae and Freddie Mac and related actions, along with any changes in laws and regulations affecting the relationship between Fannie Mae and Freddie Mac and the U.S. federal government, could materially and adversely affect our Agency Business.***

Currently, the Agency Business originates a majority of its loans for sale through GSE programs. Additionally, a substantial majority of our servicing rights are derived from loans we sell through GSE programs. Changes in the business charters, structure, or existence of one or both of the GSEs could eliminate or substantially reduce the number of loans we may originate with the GSEs, which in turn would lead to a reduction in fee and interest income we derive with respect to such loans and would also adversely affect our servicing revenue. These effects would likely cause our Agency Business to realize significantly lower revenues from our loan originations and servicing fees and ultimately would have a material adverse impact on our financial results.

*Conservatorships of the GSEs*

In September 2008, the Federal Housing Finance Agency (the "FHFA"), the GSEs' regulator, placed each GSE into conservatorship. The conservatorship is a statutory process designed to preserve and conserve the GSEs' assets and property and put them in a sound and solvent condition. The conservatorships have no specified termination dates and there continues to be significant uncertainty regarding the future of the GSEs, including how long they will continue to exist in their current forms, the extent of their roles in the housing markets, what forms they will have and whether they will continue to exist following conservatorship.

*Housing Finance Reform*

Policymakers and others have focused significant attention in recent years on how to reform the nation's housing finance system, including what role, if any, the GSEs should play. In 2011, the Obama Administration released a white paper on the future of housing finance reform. The report provided that the Obama Administration would work with the FHFA to determine the best way to responsibly reduce the GSEs' role in the market and ultimately wind down both institutions. The report identified a number of possible policy steps for winding down the GSEs, reducing the government's role in housing finance and helping bring private capital back to the mortgage market. In August 2013, President Obama publicly discussed the Administration's housing policy priorities, including a core principle that included winding down the GSEs through a responsible transition. In January 2014, the White House issued a fact sheet reaffirming the Administration's view that housing finance reform should include ending the GSEs' business model.

In addition to the Administration's actions described above, the FHFA has taken a number of steps consistent with the goals laid out in the former Administration's 2011 white paper. In 2012, the FHFA proposed a strategic plan for the GSEs' conservatorships. Among other things, that strategic plan recognized that the GSEs' multifamily business, in contrast to their single-family business, had remained cash flow positive during the recent housing crisis. The strategic plan stated that "generating potential value for taxpayers and contracting the GSEs' multifamily market footprint should be approached differently from single-family, and it may be accomplished using a much different and more direct method."

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In 2014, the FHFA released its strategic plan for the GSEs, in which it changed its goal of "contraction" of the GSEs' multifamily businesses to "maintaining" the businesses. In 2015, the FHFA released the GSEs' 2016 Scorecard (the "2016 Scorecard"), which set the multifamily loan origination caps for each GSE at \$31.0 billion ("2016 Caps"), excluding affordable housing loans, loans to small multifamily properties, and manufactured housing rental community loans. The 2016 Scorecard also stated that the FHFA will review the agencies estimates of the multifamily loan origination market size on a quarterly basis and, if it determines that the actual 2016 market size was greater than projected, it would apply an appropriate increase, but would not reduce the cap if the actual market size was less than projected. In fact, during 2016, the FHFA increased the 2016 Caps to \$36.5 billion for each of the GSEs. The FHFA has released the GSE 2017 Scorecard ("2017 Scorecard"), which kept the loan origination caps for each GSE at \$36.5 billion ("2017 Caps"), no change from the 2016 Caps, continues to exclude affordable housing loans, loans to small multifamily properties, and manufactured housing rental community loans and maintains its flexibility for quarterly review for potential adjustments should the market be larger than expected. The 2017 Scorecard also provides exclusions for loans to properties in underserved markets including rural, small multifamily and senior assisted living and for loans to finance energy or water efficiency improvements.

Congress has also continued to consider housing finance reform. In the past few years, members of Congress introduced several bills to reform the housing finance system, including the GSEs. Several of the bills require the wind down or receivership of the GSEs within a specified period of enactment and also place certain restrictions on the GSEs' activities prior to being wound down or placed into receivership. The Trump Administration has made comments indicating that housing finance reform may be on their agenda, however, it is unclear at this time what the Trump Administration's goals are with respect to the future of the GSE's.

We expect Congress will continue to consider housing finance reform, including conducting hearings and considering legislation that would alter the housing finance system, including the activities or operations of the GSEs. We cannot predict the prospects for the enactment, timing or content of legislative proposals regarding the future status of the GSEs. As a result, there continues to be significant uncertainty regarding the future of the GSEs.

***Our Agency Business is subject to risk of loss in connection with defaults on loans sold under the Fannie Mae DUS program that could materially and adversely affect our results of operations and liquidity.***

Under the Fannie Mae DUS program, our Agency Business originates and services multifamily loans for Fannie Mae without having to obtain Fannie Mae's prior approval for certain loans, as long as the loans meet the underwriting guidelines set forth by Fannie Mae. In return for the delegated authority to make loans and the commitment to purchase loans by Fannie Mae, we must maintain minimum collateral with Fannie Mae and we are required to share risk of loss on loans sold through Fannie Mae. Under the full risk-sharing formula, we absorb the first 5% of any losses on the unpaid principal balance of a loan at the time of loss settlement, and above 5% we share the loss with Fannie Mae, with our maximum loss capped at 20% of the original unpaid principal balance of a loan. Our Agency Business has modified its risk-sharing obligations on some Fannie Mae DUS loans to reduce potential loss exposure on those loans. In addition, Fannie Mae can double or triple our risk-sharing obligations if the loan does not meet specific underwriting criteria or if the loan defaults within 12 months of its sale to Fannie Mae. As of December 31, 2016, the Agency Business had pledged \$38.1 million as collateral against future losses under \$11.18 billion of loans outstanding that are subject to risk-sharing obligations. Fannie Mae collateral requirements may change in the future. As of December 31, 2016, the Agency Business's allowance for loss-sharing balance was \$32.4 million. We cannot ensure that this balance will be sufficient to cover future loss sharing obligations. While our Agency Business originates loans that meet the underwriting guidelines defined by Fannie Mae, in addition to our own internal underwriting guidelines, underwriting criteria may not always protect

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against loan defaults. Other factors may also affect a borrower's decision to default on a loan, such as property, cash flow, occupancy, maintenance needs and other financing obligations. If loan defaults increase, our risk-sharing obligation payments under the Fannie Mae DUS program may increase and such defaults and payments could have a material adverse effect on our results of operations and liquidity. In addition, any failure to pay our share of losses under the Fannie Mae DUS program could result in the revocation of our license from Fannie Mae and in the exercise of various remedies available to Fannie Mae under the Fannie Mae DUS program, including the transfer of our servicing portfolio to another Fannie Mae approved servicer.

***If we fail to act proactively with delinquent borrowers in an effort to avoid a default, the number of delinquent loans could increase, which could have a material adverse effect on us.***

As a loan servicer for GSEs and HUD, we are the primary contact with the borrower throughout the life of the loan and we are responsible, pursuant to agreements with the GSEs, HUD and institutional investors, for asset management. We are also responsible, together with the applicable GSE, HUD, or institutional investor, for taking actions to mitigate losses. We believe we have developed an effective asset management process for tracking each loan we service. However, we may be unsuccessful in identifying loans that are in danger of underperforming or defaulting or in taking appropriate action once those loans are identified. While we can make recommendations, decisions regarding loss mitigation are within the control of the GSEs, HUD and institutional investors. When loans become delinquent, we may incur additional expenses in servicing and asset managing the loans and we are required to advance principal and interest payments and tax and insurance escrow amounts. Our Agency Business could also be subject to a loss of its contractual servicing fee, and it could suffer losses of up to 20% (or more for loans that do not meet specific underwriting criteria or default within 12 months) of the unpaid principal balance of a Fannie Mae DUS loan with full risk-sharing. These items could have a negative impact on our cash flows and a negative effect on the net carrying value of the mortgage servicing right ("MSR") on our balance sheet and could result in a charge to our earnings. As a result of the foregoing, a rise in delinquencies could have a material adverse effect on our Agency Business.

***A reduction in the prices paid for the loans and services of our Agency Business or an increase in loan or security interest rates by investors could materially and adversely affect our results of operations and liquidity.***

The Agency Business's results of operations and liquidity could be materially and adversely affected if the GSEs, HUD or institutional investors lower the price they are willing to pay for loans or services or adversely change the material terms of their loan purchases or servicing arrangements with us. A number of factors determine the price we receive for our agency loans. With respect to Fannie Mae related originations, loans are generally sold as Fannie Mae insured securities to third-party investors. With respect to HUD related originations, loans are generally sold as Ginnie Mae securities to third-party investors. In both cases, the price paid to us reflects, in part, the competitive market bidding process for these securities.

Our Agency Business sells loans directly to Freddie Mac. Freddie Mac may choose to hold, sell or later securitize such loans. We believe terms set by Freddie Mac are influenced by similar market factors as those that impact the price of Fannie Mae insured or Ginnie Mae securities, although the pricing process differs. With respect to loans that are placed with institutional investors, the origination fees that we receive from borrowers are determined through negotiations, competition and other market conditions.

Loan servicing fees are based, in part, on the risk-sharing obligations associated with the loan and the market pricing of credit risk. The credit risk premium offered by Fannie Mae for new loans can change periodically but remains fixed once we enter into a commitment to sell the loan. Over the past several years, Fannie Mae loan servicing fees have been higher due to the market pricing of credit risk. There can be no assurance that such fees will continue to remain at such levels or that such levels will be sufficient if delinquencies occur.

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***A significant portion of our Agency Business's revenue is derived from loan servicing fees, and declines in, or terminations of, servicing engagements or breaches of servicing agreements, including as a result of non-performance by third parties that we engage for back-office loan servicing functions, could have a material adverse effect on us.***

We expect that loan servicing fees will constitute a significant portion of our Agency Business's revenues for the foreseeable future. Nearly all of these fees are derived from loans that have been originated and sold through GSE and HUD programs. A decline in the number or value of loans that the Agency Business originates for these investors or terminations of its servicing engagements will decrease these fees. HUD has the right to terminate our current servicing engagements for cause. In addition to termination for cause, Fannie Mae and Freddie Mac may terminate our servicing engagements without cause by paying a termination fee. The Agency Business is also subject to losses that may arise as a result of servicing errors, such as a failure to maintain insurance, pay taxes or provide required notices. In addition, we have contracted with a third party to perform certain routine back-office aspects of loan servicing. If we, or this third party, fail to perform, or we breach, or the third-party causes a breach, of our servicing obligations to the GSEs or HUD, our servicing engagements may be terminated. Declines or terminations of servicing engagements or breaches of such obligations could materially and adversely affect our financial results.

***We satisfy a portion of our restricted liquidity requirements with Fannie Mae with a letter of credit issued by one of our lenders. If the letter of credit became unavailable to us for any reason, we could suffer a significant reduction in our cash flow from operations, or we may breach our obligations to Fannie Mae, which would have a material adverse effect on our Agency Business.***

Our Agency Business is required to pledge restricted cash as collateral for possible losses resulting from loans originated under the Fannie Mae DUS program in accordance with the terms of loss sharing agreements with Fannie Mae. As of December 31, 2016, this requirement totaled \$38.1 million, of which \$25.0 million was satisfied with a letter of credit issued to Fannie Mae by one of our lenders and the balance funded by cash. Our letter of credit facility expires in October of 2018. The facility is collateralized by the servicing cash flow generated from the Agency Business's Fannie Mae portfolio and contains certain financial and other covenants. If we fail to satisfy any of these covenants, or we are unable to renew or replace this facility on favorable terms, or at all, it could have a material adverse effect on our cash flow and our financial condition. If we were unable to replace the letter of credit facility with either a similar facility or cash, we would be in breach of our obligations to Fannie Mae, which would have a material adverse effect on our business and operations.

***The Agency Business is subject to the risk of failed loan deliveries, and even after a successful closing and delivery, may be required to repurchase the loan or to indemnify the investor if there is a breach of a representation or warranty made by the Agency Business in connection with the sale of the loan through a GSE or HUD program, any of which could have a material adverse effect on us.***

Our Agency Business bears the risk that a borrower will choose not to close on a loan that has been pre-sold to an investor or that the investor will choose not to purchase a loan under certain circumstances, including, for example, a significant casualty event that impacts the condition of a property after we fund the loan and prior to the investor purchase date. We also bear the risk of serious errors in loan documentation that prevent timely delivery of the loan prior to the investor purchase date. A complete failure to deliver a loan could be a default under the warehouse line used to finance the loan. Although the Agency Business has experienced only three failed loan deliveries in its history, none of which had a material impact on its financial condition or results of operations, we can provide no assurance that we will not experience additional failed deliveries in the future or that any losses will not be material or will be mitigated through property insurance or payment protections.

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We must make certain representations and warranties concerning each loan we originate for GSE or HUD programs. The representations and warranties relate to our practices in the origination and servicing of the loans and the accuracy of the information being provided by us. For example, we are generally required to provide the following, among other, representations and warranties: we are authorized to do business and to sell or assign the loan; the loan conforms to the requirements of the GSE or HUD and certain laws and regulations; the underlying mortgage represents a valid first lien on the property and there are no other liens on the property; the loan documents are valid and enforceable; taxes, assessments, insurance premiums, rents and similar other payments have been paid or escrowed; the property is insured, conforms to zoning laws and remains intact; and we do not know of any issues regarding the loan that are reasonably expected to cause the loan to be delinquent or unacceptable for investment or adversely affect its value. We are permitted to satisfy certain of these representations and warranties by furnishing a title insurance policy.

In the event of a breach of any representation or warranty, investors could, among other things, require us to repurchase the full amount of the loan and seek indemnification for losses from it or, in the case of Fannie Mae, increase the level of risk-sharing on the loan. Our obligation to repurchase the loan is independent of our risk-sharing obligations. The GSEs or HUD could require us to repurchase a loan if representations and warranties are breached, even if the loan is not in default. Because the accuracy of many such representations and warranties generally is based on our actions or on third-party reports, such as title reports and environmental reports, we may not receive similar representations and warranties from other parties that would serve as a claim against them. Even if we receive representations and warranties from third parties and have a claim against them in the event of a breach, our ability to recover on any such claim may be limited. Our ability to recover against a borrower that breaches its representations and warranties to us may be similarly limited. Our ability to recover on a claim against any party would also be dependent, in part, upon the financial condition and liquidity of such party. Although we believe that we have capable personnel at all levels, uses qualified third parties and have established controls to ensure that all loans are originated pursuant to requirements established by the GSEs and HUD, in addition to its own internal requirements, there can be no assurance that we, our employees or third parties will not make mistakes. Any significant repurchase or indemnification obligations imposed on us could have a material adverse effect on the Agency Business.

***For most loans we service under the Fannie Mae and HUD programs, we are required to advance payments due to investors if the borrower is delinquent in making such payments, which requirement could adversely impact our liquidity and harm our results of operations.***

For most loans we service under the Fannie Mae DUS program, we are required to advance the principal and interest payments and tax and insurance escrow amounts if the borrower is delinquent in making loan payments. After four continuous months of making advances on behalf of the borrower, we can submit a reimbursement claim to Fannie Mae, which Fannie Mae may approve at its discretion. We are reimbursed by Fannie Mae for these advances in the event the loan is brought current. In the event of a default, any advances made by the Agency Business are used to reduce the proceeds required to settle any loss. Our advances may also be reimbursed, to the extent that the default settlement proceeds on the collateral exceed the unpaid principal balance.

Under the HUD program, we are obligated to advance tax and insurance escrow amounts and principal and interest payments on the underlying loan until the Ginnie Mae security has been fully paid. In the event of a default on a HUD insured loan, we can elect to assign the loan to HUD and file a mortgage insurance claim. HUD will reimburse approximately 99% of any losses of principal and interest on the loan and Ginnie Mae will reimburse most of the remaining losses of principal and interest.

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Although the Agency Business has historically funded all required advances from operating cash flow, there can be no assurance we will be able to do so in the future. If the Agency Business does not have sufficient operating cash flows to fund such advances, we may need to finance such amounts. Such financing may not be available to us, or, if it is available, may be costly and could prevent the Agency Business from pursuing its business and growth strategies.

***Our Agency Business may not be able to hire and retain qualified loan originators or grow and maintain its relationships with key customers, and if we are unable to do so, our ability to implement our business and growth strategies could be limited.***

The Agency Business depends on its loan originators to generate borrower clients by, among other things, developing relationships with commercial property owners, real estate agents and brokers, developers and others, which leads to repeat and referral business. Accordingly, we must be able to attract, motivate and retain skilled loan originators. The market for loan originators is highly competitive and may lead to increased costs to hire and retain them. We cannot guarantee that we will be able to attract or retain qualified loan originators. If we cannot attract, motivate or retain a sufficient number of skilled loan originators, or even if we can motivate or retain them but at higher costs, we could be materially and adversely affected.

### **Risks Relating to Regulatory Matters**

***If our Agency Business fails to comply with the numerous government regulations and program requirements of the GSEs and HUD, we may lose our approved lender status with these entities and fail to gain additional approvals or licenses for our business. We are also subject to changes in laws, regulations and existing GSE and HUD program requirements, including potential increases in reserve and risk retention requirements that could increase our costs and affect the way we conduct the Agency Business, which could materially and adversely affect our financial results.***

The Agency Business's operations are subject to regulation by federal, state and local government authorities, various laws and judicial and administrative decisions, and regulations and policies of the GSEs and HUD. These laws, regulations, rules and policies impose, among other things, minimum net worth, operational liquidity and collateral requirements. Fannie Mae requires the Agency Business to maintain operational liquidity based on a formula that considers the balance of the loan and the level of credit loss exposure (level of risk-sharing). Fannie Mae requires its DUS lenders to maintain collateral, which may include pledged securities, for their risk-sharing obligations. The amount of collateral required under the Fannie Mae DUS program is calculated at the loan level and is based on the balance of the loan, the level of risk-sharing, the seasoning of the loans and the rating of the Fannie Mae DUS lender.

Regulatory authorities also require the Agency Business to submit financial reports and to maintain a quality control plan for the underwriting, origination and servicing of loans. Numerous laws and regulations also impose qualification and licensing obligations on the Agency Business and impose requirements and restrictions affecting, among other things: the Agency Business's loan originations; maximum interest rates, finance charges and other fees that we may charge; disclosures to consumers; the terms of secured transactions; collection, repossession and claims handling procedures; personnel qualifications; and other trade practices. The Agency Business is also subject to inspection by the GSEs, HUD, and regulatory authorities. Any failure to comply with these requirements could lead to, among other things, the loss of a license as an approved GSE or HUD lender, the inability to gain additional approvals or licenses, the termination of contractual rights without compensation, demands for indemnification or loan repurchases, class action lawsuits and administrative enforcement actions.

Regulatory and legal requirements are subject to change. For example, Fannie Mae increased its collateral requirements, on loans classified by Fannie Mae as Tier II, from 60 basis points to 75 basis

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points, effective as of January 1, 2013, which applied to a large portion of the Agency Business's outstanding Fannie Mae at risk portfolio. The incremental requirement for any newly originated Fannie Mae Tier II loans will be funded over the 48 months subsequent to the sale of the loan to Fannie Mae. Fannie Mae has indicated that it may increase collateral requirements in the future, which may adversely impact our Agency Business.

*If we fail to comply with laws, regulations and market standards regarding the privacy, use, and security of customer information, or if we are the target of a successful cyber-attack, we may be subject to legal and regulatory actions and our reputation would be harmed.*

We receive, maintain, and store the non-public personal information of our loan applicants. The technology and other controls and processes designed to secure our customer information and to prevent, detect, and remedy any unauthorized access to that information were designed to obtain reasonable, not absolute, assurance that such information is secure and that any unauthorized access is identified and addressed appropriately. We are not aware of any data breaches, successful hacker attacks, unauthorized access and misuse, or significant computer viruses affecting our networks that may have occurred in the past; however, our controls may not have detected, and may in the future fail to prevent or detect, unauthorized access to our borrower information. If this information is inappropriately accessed and used by a third party or an employee for illegal purposes, such as identity theft, we may be responsible to the affected applicant or borrower for any losses that may have been incurred as a result of misappropriation. In such an instance, we may be liable to a governmental authority for fines or penalties associated with a lapse in the integrity and security of our customers' information.

**Risks Related to the Agency Business Acquisition**

*We may be unable to integrate the Agency Business successfully.*

We have and will continue to devote significant management attention and resources to integrating the Agency Business practices and operations with our own. The areas in which we may face risks include:

challenges of effectively integrating our credit standards, which we believe are material contributors to our success;

failure to implement or improve internal controls, procedures and policies appropriate for a public company;

the potential inability to successfully maintain and develop the Agency Business mortgage loan origination and servicing portfolio;

complexities associated with managing the Acquisition of the Agency Business with our existing business; and

potential unknown liabilities and unforeseen increased expenses or delays associated with the Acquisition.

In addition, it is possible that the integration process could result in diversion of the attention of our management which could adversely affect our ability to achieve the anticipated benefits of the Acquisition.

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***We may have failed to uncover all liabilities of the Agency Business through the due diligence process prior to the Acquisition, exposing us to potentially large, unanticipated costs.***

We have assumed the liabilities of the Agency Business pursuant to the Acquisition and if we failed to identify all such liabilities, or inadequately valued them, it could materially and adversely affect our business, results of operations and financial condition.

**Risks Related to Our Corporate and Ownership Structure**

***We are substantially controlled by our Manager and Mr. Kaufman.***

Mr. Ivan Kaufman, our chairman, chief executive officer and president and the chief executive officer of our Manager, beneficially owns approximately 92% of the outstanding membership interests of our Manager. Our Manager has approximately 36.6% of the voting power of our outstanding stock as of December 31, 2016. As a result of Mr. Kaufman's beneficial ownership of stock held by our Manager as well as his beneficial ownership of additional shares of our common stock, Mr. Kaufman has approximately 37.3% of the voting power of our outstanding stock as of December 31, 2016. Because of his position with us and our Manager and his ability to effectively vote a substantial minority of our outstanding stock, Mr. Kaufman has significant influence over our policies and strategy.

***Our charter generally does not permit ownership in excess of 5% of our capital stock, and attempts to acquire our capital stock in excess of this limit are ineffective without prior approval from our Board of Directors.***

For the purpose of preserving our REIT qualification, our charter generally prohibits a beneficial or constructive ownership by any person of more than 5% (by value or by number of shares, whichever is more restrictive) of the outstanding shares of our common stock or 5% (by value) of our outstanding shares of stock of all classes or series (excluding OP Units), unless an exemption is granted by the Board of Directors. Our charter's constructive ownership rules are complex and may cause the outstanding stock owned by a group of related individuals or entities to be deemed to be constructively owned by one individual or entity. As a result, the acquisition of less than these percentages of the outstanding stock by an individual or entity could cause that individual or entity to own constructively in excess of these percentages of the outstanding stock and thus be subject to our charter's ownership limit. Any attempt to own or transfer shares of our common or preferred stock in excess of the ownership limit without the consent of the Board of Directors will result in the shares being automatically transferred to a charitable trust or otherwise voided. Our Board of Directors have approved resolutions under our charter allowing Ivan Kaufman and our Manager, in relation to Mr. Kaufman's controlling equity interest, C. Michael Kojaian, a former director, as well as three outside investors to own more than the ownership interest limit of our common stock stated in our charter.

***Our staggered board and other provisions of our charter and bylaws may prevent a change in our control.***

Our Board of Directors is divided into three classes of directors. The current terms of the Class I, Class II and Class III directors will expire in 2019, 2017 and 2018, respectively. Directors of each class are chosen for three year terms upon the expiration of their current terms, and each year one class of directors is elected by the stockholders. The staggered terms of our directors may reduce the possibility of a tender offer or an attempt at a change in control, even though a tender offer or change in control might be in the best interest of our stockholders. In addition, our charter and bylaws also contain other provisions that may delay or prevent a transaction or a change in control that might involve a premium price for our common stock or otherwise be in the best interest of our stockholders.



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**Risks Related to Conflicts of Interest with Our Manager**

*We are dependent on our Manager with whom we have conflicts of interest.*

We have 288 employees, including Messrs. Kaufman, Weber, Kilgore, and Guziewicz, and are dependent upon our Manager to provide certain services to us that are vital to our operations. Our Manager has approximately 36.6% of the voting power of the outstanding shares of our capital stock as of December 31, 2016 and Mr. Kaufman, our chairman and chief executive officer and the chief executive officer of our Manager, beneficially owns these shares. Mr. Martello, one of our directors, is the chief operating officer of Arbor Management, LLC (the managing member of our Manager) and a trustee of two trusts which own minority membership interests in our Manager. Mr. Bishar, our secretary, is general counsel to our Manager. Mr. Elenio, our chief financial officer and treasurer, is the chief financial officer of our Manager. Each of Messrs. Kaufman, Martello, Bishar, Elenio, Weber, Kilgore and Guziewicz are members of our Manager's executive committee and all, but excluding Mr. Kaufman, own minority membership interests in our Manager.

We may enter into transactions with our Manager outside the terms of the management agreement with the approval of a majority vote of the independent members of our Board of Directors. Transactions required to be approved by a majority of our independent directors include, but are not limited to, our ability to purchase securities, mortgages and other assets from our Manager or to sell securities and assets to our Manager. Our Manager may from time to time provide permanent mortgage loan financing to clients of ours, which will be used to refinance bridge financing provided by us. We and our Manager may also make loans to the same borrower or to borrowers that are under common control. Additionally, our policies and those of our Manager may require us to enter into intercreditor agreements in situations where loans are made by us and our Manager to the same borrower.

We have entered into a management agreement with our Manager under which our Manager provides us with certain professional services, including underwriting, accounting and treasury, compliance, marketing, information technology and human resources.

The results of our operations are dependent upon the availability of, and our Manager's ability to identify and capitalize on, investment opportunities. Our Manager's officers and employees are also responsible for providing the same services for our Manager's investment portfolio. As a result, they may not be able to devote sufficient time to the management of our business operations.

*Our directors have approved very broad investment guidelines for our Manager and do not approve each investment decision made by our Manager.*

Our Manager is authorized to follow very broad investment guidelines. Our directors will periodically review our investment guidelines and our investment portfolio. However, our board does not review each proposed investment. In addition, in conducting periodic reviews, the directors rely primarily on information provided to them by our Manager. Furthermore, transactions entered into by our Manager may be difficult or impossible to unwind by the time they are reviewed by the directors. Our Manager has great latitude within the broad investment guidelines in determining the types of assets it may decide are proper investments for us.

*Our Manager has broad discretion to invest funds and may acquire Structured finance assets where the investment returns are substantially below expectations or that result in net operating losses.*

Our Manager has broad discretion, within the general investment criteria established by our Board of Directors, to allocate our capital and to determine the timing of investment of such capital. Such discretion could result in allocation of capital to assets, particularly in our Structured Business, where

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the investment returns are substantially below expectations or that result in net operating losses, which would materially and adversely affect our business, operations and results.

The management compensation structure that we have agreed to with our Manager may cause our Manager to invest in high risk investments. Our Manager is entitled to a base management fee, which is based on an agreed upon budget that represents the actual cost of managing the business. Our Manager is also entitled to receive incentive compensation based in part upon our achievement of targeted levels of funds from operations. In evaluating investments and other management strategies, the opportunity to earn incentive compensation based on funds from operations may lead our Manager to place undue emphasis on the maximization of funds from operations at the expense of other criteria, such as preservation of capital, in order to achieve higher incentive compensation. Investments with higher yield potential are generally riskier or more speculative. This could result in increased risk to the value of our invested portfolio.

**Risks Related to Our Status as a REIT**

*If we fail to remain qualified as a REIT, we will be subject to tax as a regular corporation and could face a substantial tax liability.*

We conduct our operations to qualify as a REIT under the Internal Revenue Code. However, qualification as a REIT involves the application of highly technical and complex Internal Revenue Code provisions for which only limited judicial and administrative authorities exist. Even a technical or inadvertent mistake could jeopardize our REIT status. Our continued qualification as a REIT will depend on our satisfaction of certain asset, income, organizational, distribution, stockholder ownership and other requirements on a continuing basis. In addition, our ability to satisfy the requirements to qualify as a REIT depends in part on the actions of third parties over which we have no control or only limited influence, including in cases where we own an equity interest in an entity that is classified as a partnership for U.S. federal income tax purposes.

Furthermore, new tax legislation, administrative guidance or court decisions, in each instance potentially with retroactive effect, could make it more difficult or impossible for us to qualify as a REIT. If we fail to qualify as a REIT in any tax year, then:

We would be taxed as a regular domestic corporation, which, among other things, means we would be unable to deduct distributions to stockholders in computing taxable income and would be subject to federal income tax on our taxable income at regular corporate rates;

Any resulting tax liability could be substantial and would reduce the amount of cash available for distribution to stockholders; and

Unless we were entitled to relief under applicable statutory provisions, we would be disqualified from treatment as a REIT for the subsequent four taxable years following the year during which we lost our qualification, and thus, our cash available for distribution to stockholders would be reduced for each of the years during which we did not qualify as a REIT.

*Even if we remain qualified as a REIT, we may face other tax liabilities that reduce our cash flow.*

Even if we remain qualified for taxation as a REIT, we may be subject to certain federal, state and local taxes on our income and assets, including taxes on any undistributed income, tax on income from some activities conducted as a result of a foreclosure, and state or local income, property and transfer taxes, such as mortgage recording taxes. Any of these taxes would decrease cash available for distribution to our stockholders. In addition, in order to meet the REIT qualification requirements, or to avert the imposition of a 100% tax that applies to certain gains derived by a REIT from dealer property or inventory, we may hold some of our assets through taxable subsidiary corporations, the income of which would be subject to federal and state income tax.

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***The Acquisition may have adverse tax consequences.***

The Acquisition is intended to constitute, for U.S. federal income tax purposes, a part sale and a part tax-deferred contribution by ACM to ARLP, and the subsequent contribution of the acquired assets and operations to our subsidiary Arbor Realty SR, Inc. is intended to constitute a tax-deferred contribution to Arbor Realty SR, Inc. As a result, neither we nor holders of our common stock, in respect of those common stock holdings, are expected to recognize gain or loss for U.S. federal income tax purposes as a result of the Acquisition.

However, as REITs, we and Arbor Realty SR, Inc. generally are unable to directly hold certain of the acquired assets and operations in connection with the Acquisition. As a result, we are holding those assets and operations through taxable REIT subsidiaries (each, a TRS) of Arbor Realty SR, Inc. A TRS is subject to regular corporate income tax on its net income. As a result, the net income generated by those operations generally are subject to regular corporate income tax.

Moreover, under the REIT asset tests (i) no more than 25% of our total gross assets may consist of nonqualifying assets, including the stock or other securities of one or more TRSs and other nonqualifying assets (such as goodwill and similar assets we acquired as a result of the Acquisition), and (ii) for 2018 and subsequent taxable years, no more than 20% of our total gross assets may consist of the stock or other securities of one or more TRSs. In addition, although dividends payable by TRSs constitute qualifying income for purposes of the 95% REIT gross income test, they are nonqualifying income for purposes of the 75% REIT gross income test. Accordingly, if the value of the business we acquired or the income generated thereby increases relative to the value of our other, REIT-compliant assets and income, we or Arbor Realty SR, Inc. may fail to satisfy one or more of the requirements applicable to REITs. Although the Acquisition is not expected to adversely affect our ability, or that of Arbor Realty SR, Inc., to continue to qualify as a REIT in the future, no assurances can be given in that regard.

***The "taxable mortgage pool" rules may increase the taxes that we or our stockholders may incur, and may limit the manner in which we effect future securitizations.***

Certain of our securitizations have resulted in the creation of taxable mortgage pools for federal income tax purposes. So long as 100% of the equity interests in a taxable mortgage pool are owned by an entity that qualifies as a REIT, including our subsidiary Arbor Realty SR, Inc., we would generally not be adversely affected by the characterization of the securitization as a taxable mortgage pool. Certain categories of stockholders, however, such as foreign stockholders eligible for treaty or other tax benefits, stockholders with net operating losses, and certain tax-exempt stockholders that are subject to unrelated business income tax, could be subject to increased taxes on a portion of their dividend income from us that is attributable to the taxable mortgage pool. In addition, to the extent that our stock is owned by tax-exempt "disqualified organizations," such as certain government-related entities that are not subject to tax on unrelated business income, we could incur a corporate level tax on a portion of our income from the taxable mortgage pool. In that case, we may reduce the amount of our distributions to any disqualified organization whose stock ownership gave rise to the tax. Moreover, we could be precluded from selling equity interests in these securitizations to outside investors, or selling any debt securities issued in connection with these securitizations that might be considered to be equity interests for tax purposes. These limitations may prevent us from using certain techniques to maximize our returns from securitization transactions.

***Complying with REIT requirements may cause us to forego otherwise attractive opportunities.***

To qualify as a REIT for federal income tax purposes we must continually satisfy tests concerning, among other things, the sources of our income, the nature and diversification of our assets, the amounts we distribute to our stockholders and the ownership of our stock. We may be required to

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make distributions to stockholders at disadvantageous times or when we do not have funds readily available for distribution. Thus, compliance with the REIT requirements may hinder our ability to operate solely on the basis of maximizing profits.

***Complying with REIT requirements may force us to liquidate otherwise attractive investments.***

To qualify as a REIT we must ensure that at the end of each calendar quarter at least 75% of the value of our assets consists of cash, cash items, government securities and qualified REIT real estate assets. The remainder of our investment in securities generally cannot comprise more than 10% of the outstanding voting securities, or more than 10% of the total value of the outstanding securities, of any one issuer. In addition, in general, no more than 5% of the value of our assets (other than assets which qualify for purposes of the 75% asset test) may consist of the securities of any one issuer, and no more than 25% of the value of our total assets may be represented by securities of one or more taxable REIT subsidiaries. If we fail to comply with these requirements, we must correct such failure within 30 days after the end of the calendar quarter to avoid losing our REIT status and suffering adverse tax consequences. As a result, we may be required to liquidate otherwise attractive investments.

***Liquidation of collateral may jeopardize our REIT status.***

To continue to qualify as a REIT, we must comply with requirements regarding our assets and our sources of income. If we are compelled to liquidate investments to satisfy our obligations to future lenders, we may be unable to comply with these requirements, ultimately jeopardizing our status as a REIT.

***We may be unable to generate sufficient revenue from operations to pay our operating expenses and to pay dividends to our stockholders.***

As a REIT, we are generally required to distribute at least 90% of our taxable income each year to our stockholders. In order to qualify for the tax benefits afforded to REITs, we intend to declare quarterly dividends and to make distributions to our stockholders in amounts such that we distribute all or substantially all of our REIT taxable income each year, subject to certain adjustments. However, our ability to make distributions may be adversely affected by the risk factors described in this report. In the event of a future downturn in our operating results and financial performance or unanticipated declines in the value of our asset portfolio, we may be unable to declare or pay quarterly dividends. The timing and amount of dividends are in the sole discretion of our Board of Directors, which considers, among other factors, our earnings, financial condition, debt service obligations and applicable debt covenants, REIT qualification requirements and other tax considerations and capital expenditure requirements as our board may deem relevant from time to time.

Among the factors that could adversely affect our results of operations and impair our ability to make distributions to our stockholders are:

use of funds and our ability to make profitable structured finance investments;

defaults in our asset portfolio or decreases in the value of our portfolio;

anticipated operating expense levels may not prove accurate, as actual results may vary from estimates; and

increased debt service requirements, including those resulting from higher interest rates on variable rate indebtedness.

A change in any one of these factors could affect our ability to make distributions. If we are not able to comply with the restrictive covenants and financial ratios contained in future credit facilities, our ability to make distributions to our stockholders may also be impaired. We cannot assure that we

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will be able to make distributions to our stockholders in the future or that the level of any distributions we make will increase over time.

***We may need to borrow funds to satisfy our REIT distribution requirements, and a portion of our distributions may constitute a return of capital. Debt service on any borrowings for this purpose will reduce our cash available for distribution.***

To qualify as a REIT, we must generally, among other requirements, distribute at least 90% of our REIT taxable income, subject to certain adjustments, to our stockholders each year. To the extent that we satisfy the distribution requirement, but distribute less than 100% of our taxable income, we will be subject to federal corporate income tax on our undistributed taxable income. In addition, we will be subject to a 4% nondeductible excise tax if the actual amount that we pay out to our stockholders in a calendar year is less than a minimum amount specified under federal tax laws.

From time to time, we may generate taxable income greater than our net income for financial reporting purposes, or our taxable income may be greater than our cash flow available for distribution to our stockholders. If we do not have other funds available in these situations we could be required to borrow funds, issue stock or sell investments at disadvantageous prices or find another alternative source of funds to make distributions sufficient to enable us to satisfy the REIT distribution requirement and to avoid corporate income tax and the 4% excise tax in a particular year.

***We may be subject to adverse legislative or regulatory tax changes that could reduce the market price of our common stock.***

Under the current tax legislation, capital gain income (including capital gain dividends that we pay) and ordinary income (including dividends that we pay which are not capital gain dividends) are generally taxable at top marginal rates of 20% and 39.6%, respectively. In addition, certain U.S. stockholders who are individuals, trusts or estates and whose income exceeds certain thresholds are required to pay a 3.8% Medicare tax on our dividends and gain from the sale of our stock. A portion of our dividends may be eligible for preferential rates in the future as "qualified dividend income," which has a top individual tax rate of 20% to U.S. stockholders. At any time, the federal income tax laws governing REITs or the administrative interpretations of those laws may change. Any such changes may have a retroactive effect, and could adversely affect us or our stockholders.

***Restrictions on share accumulation in REITs could discourage a change of control of us.***

In order for us to qualify as a REIT, not more than 50% of the value of our outstanding shares of capital stock may be owned, directly or indirectly, by five or fewer individuals during the last half of a taxable year.

To prevent five or fewer individuals from acquiring more than 50% of our outstanding shares and a resulting failure to qualify as a REIT, our charter provides that, subject to certain exceptions, no person, including entities, may own, or be deemed to own by virtue of the attribution provisions of the Internal Revenue Code, more than 5% of the aggregate value or number of shares (whichever is more restrictive) of our outstanding common stock, or more than 5%, by value, of our outstanding shares of stock of all classes or series, in the aggregate.

Shares of our stock that would otherwise be directly or indirectly acquired or held by a person in violation of the ownership limitations are, in general, automatically transferred to a trust for the benefit of a charitable beneficiary, and the purported owner's interest in such shares is void. In addition, any person who acquires shares in excess of these limits is obliged to immediately give written notice to us and provide us with any information we may request in order to determine the effect of the acquisition on our status as a REIT.

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While these restrictions are designed to prevent any five individuals from owning more than 50% of our shares, they could also discourage a change in control of our company. These restrictions may also deter tender offers that may be attractive to stockholders or limit the opportunity for stockholders to receive a premium for their shares if an investor makes purchases of shares to acquire a block of shares.

**Item 1B. Unresolved Staff Comments**

None.

**Item 2. Properties**

Our principle corporate offices are located in leased space at 333 Earle Ovington Boulevard, Uniondale, New York, 11553.

**Item 3. Legal Proceedings**

We are not involved in any material litigation nor, to our knowledge, is any material litigation threatened against us other than the litigation described in Note 16 Commitments and Contingencies Litigation of this report. We have not made a loss accrual for this litigation because we believe that it is not probable that a loss has been incurred and an amount cannot be reasonably estimated.

**PART II**

**Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

**Market Information**

Our common stock is listed on the New York Stock Exchange ("NYSE") under the symbol "ABR." On February 24, 2017, the closing sale price for our common stock, as reported on the NYSE, was \$7.36 and there were 9,492 record holders of our common stock, including persons holding shares in broker accounts under street names. The following table shows the intra-day high and low sales prices per share as reported on the NYSE and dividends declared and paid for the past two years.

	High	Low	Dividends Declared		High	Low	Dividends Declared
<b>2016</b>				<b>2015</b>			
Fourth Quarter(1)	\$ 7.88	\$ 6.92	\$ 0.16	Fourth Quarter	\$ 7.31	\$ 6.25	\$ 0.15
Third Quarter	\$ 7.99	\$ 7.00	\$ 0.16	Third Quarter	\$ 6.94	\$ 6.03	\$ 0.15
Second Quarter	\$ 7.20	\$ 6.59	\$ 0.15	Second Quarter	\$ 7.21	\$ 6.55	\$ 0.15
First Quarter	\$ 7.35	\$ 6.01	\$ 0.15	First Quarter	\$ 7.42	\$ 6.75	\$ 0.13

(1) On March 1, 2017, our Board of Directors declared a dividend of \$0.17 per common share for the fourth quarter of 2016.

We are organized and conduct our operations to qualify as a REIT, which requires that we distribute at least 90% of taxable income. No assurance, however, can be given as to the amounts or timing of future distributions as such distributions are subject to our taxable earnings, financial condition, capital requirements and such other factors as our Board of Directors deems relevant.

Table of Contents**Equity Compensation Plan Information**

The following table presents information as of December 31, 2016 regarding the 2014 Omnibus Stock Incentive Plan (the "2014 Plan") and the incentive compensation provisions of our management agreement with our Manager, which are our only equity compensation plans:

<b>Plan Category</b>	<b>Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights</b>	<b>Weighted Average Exercise Price of Outstanding Options, Warrants and Rights</b>	<b>Number of Securities Remaining Available for Future Issuance</b>
Equity compensation plans approved by security holders:			
2014 Omnibus Stock Incentive Plan(1)	0	N/A	735,013
Incentive compensation pursuant to management agreement(2)	0	N/A	See Note 3
Equity compensation plans not approved by security holders	N/A	N/A	N/A
<b>Total</b>	<b>0</b>	<b>N/A</b>	<b>735,013</b>

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(1) On May 20, 2014, the stockholders approved the 2014 Plan.

(2) Pursuant to the terms of our management agreement with our Manager, at least 25% of the incentive compensation earned by our Manager is payable in shares of our common stock having a value equal to the average closing price per share for the last twenty days of the fiscal quarter for which the incentive compensation is being paid. Our Manager has the right to elect to receive 100% of the incentive compensation in shares of our common stock. See Note 20 - Agreements and Transactions with Related Parties for information on our management agreement and incentive compensation payable to our Manager thereunder.

(3) The number of securities remaining available for future issuance to our Manager as incentive compensation pursuant to the management agreement depends on the amount of incentive compensation earned by our Manager in the future and therefore is not yet determinable. We incurred no incentive compensation pursuant to the management agreement in 2016, 2015 or 2014.

Table of Contents**Performance Graph**

The graph below compares the cumulative total stockholder return for our common stock with the Russell 2000 Index, the NAREIT All REIT Index and the FTSE NAREIT Mortgage REITs Index for the five year period from December 31, 2011 to December 31, 2016. The graph assumes a \$100 investment on January 1, 2012 and the reinvestment of any dividends. This graph is not necessarily indicative of future stock price performance. The information included in the graph and table below was obtained from SNL Financial LC, Charlottesville, VA ©2016.

**Total Return Performance**

Index	Period Ended					
	12/31/11	12/31/12	12/31/13	12/31/14	12/31/15	12/31/16
Arbor Realty Trust, Inc.	100.00	179.23	213.32	233.60	268.86	305.89
Russell 2000	100.00	116.35	161.52	169.43	161.95	196.45
NAREIT All REIT	100.00	120.14	124.00	157.66	161.27	176.24
FTSE NAREIT Mortgage REITs	100.00	119.89	117.54	138.56	126.26	155.11

In accordance with SEC rules, this section entitled "Performance Graph" shall not be incorporated by reference into any of our future filings under the Securities Act or the Exchange Act, and shall not be deemed to be soliciting material or to be filed under the Securities Act or the Exchange Act.



Table of Contents**Item 6. Selected Financial Data**

The following selected historical consolidated financial information should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our historical consolidated financial statements and related notes included in this report. Prior period amounts have been reclassified to conform to current period presentation.

	Year Ended December 31,				
	2016(1)	2015	2014	2013	2012
<b>Operating Data:</b>					
Interest income	\$ 116,172,621	\$ 106,768,542	\$ 106,716,344	\$ 99,031,623	\$ 79,998,762
Other interest income, net	2,539,274	7,884,344			
Interest expense	63,622,771	49,720,132	47,903,458	42,065,151	40,866,832
Net interest income	55,089,124	64,932,754	58,812,886	56,966,472	39,131,930
Gain on sales, including fee-based services, net	24,594,090				
Mortgage servicing rights	44,940,760				
Servicing revenue, net	9,054,199				
Employee compensation and benefits	38,647,446	17,500,457	13,978,223	12,042,332	10,173,572
Selling and administrative	17,586,871	9,392,136	9,600,139	9,253,247	7,882,914
Acquisition costs	10,261,902	3,133,681		1,350,000	
Impairment loss on real estate owned	11,200,000		250,000		
Provision for loss sharing	2,234,823				
Provision for loan losses (net of recoveries)	(134,101)	4,466,886	(308,511)	4,287,652	22,946,396
Management fee related party	12,600,000	10,900,000	9,900,000	10,900,000	10,000,000
Gain on acceleration of deferred income		19,171,882			
Gain on sale of real estate	11,630,687	7,784,021	1,603,763		3,953,455
Gain on sale of equity interests, net			66,745,517		
Gain on extinguishment of debt				4,930,772	30,459,023
Income (loss) from equity affiliates	12,994,607	12,300,516	248,658	(204,475)	(697,856)
Income from continuing operations	62,480,893	53,428,814	93,048,490	21,298,737	16,388,417
Net income	62,480,893	53,428,814	93,048,490	21,298,737	21,716,455
Preferred stock dividends	7,553,720	7,553,720	7,256,255	4,506,583	
Net income attributable to common stockholders	42,796,132	45,875,094	85,792,235	16,667,955	21,500,888
<b>Share Data:</b>					
Income from continuing operations per share, basic(2)	0.83	0.90	1.71	0.39	0.60
Income per share, basic(2)	0.83	0.90	1.71	0.39	0.80
Income from continuing operations per share, diluted(2)(3)	0.83	0.90	1.70	0.39	0.59
Income per share, diluted(2)(3)	0.83	0.90	1.70	0.39	0.79
Dividends declared per common share	0.62	0.58	0.52	0.50	0.29

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	December 31,				
	2016(1)	2015	2014	2013	2012
<b>Balance Sheet Data:</b>					
Loans and investments, net	\$ 1,695,732,351	\$ 1,450,334,341	\$ 1,459,475,650	\$ 1,523,699,653	\$ 1,325,667,053
Loans held-for-sale, net	673,367,304				
Capitalized mortgage servicing rights, net	227,742,986				
Goodwill and other intangible assets	97,489,884				
Total assets	2,970,786,246	1,827,391,944	1,866,494,039	1,868,383,412	1,694,025,602
Total debt	2,018,118,058	1,173,188,920	1,246,080,417	1,269,701,365	1,286,734,643
Redeemable preferred stock	89,508,213	89,295,905	89,295,905	67,654,655	
Total equity	747,037,928	565,090,775	535,455,471	437,596,282	231,261,122

	Year Ended December 31,				
	2016(1)	2015	2014	2013	2012
<b>Loan Volume Data:</b>					
<u>Structured Business</u>					
<u>Originations</u>					
New loan originations	\$ 847,682,500	\$ 828,217,500	\$ 900,666,405	\$ 591,537,200	\$ 274,516,550
Loan payoffs / paydowns	553,408,734	828,669,556	972,311,886	402,162,170	269,904,723
<u>Agency Business</u>					
<u>Originations</u>					
Fannie Mae	\$ 1,668,581,271	\$	\$	\$	\$
Freddie Mac	456,421,660				
FHA	24,629,823				
Total	\$ 2,149,632,754	\$	\$	\$	\$

Total loan commitment volume	\$ 2,129,720,318	\$	\$	\$
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	Year Ended December 31,				
	2016(1)	2015	2014	2013	2012
<u>Agency Business Loan Sales</u>					
Fannie Mae	\$ 1,130,391,796	\$	\$	\$	\$
Freddie Mac	332,319,660				
FHA	29,672,932				
Total(4)	\$ 1,492,384,388	\$	\$	\$	\$

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Sales margin (fee-based services as a % of loan sales) 1.65%

MSR rate (MSR income as a % of loan commitments) 2.11%

**Other Data:**

Funds from operations(5)	\$	56,882,741	\$	43,901,754	\$	92,078,433	\$	25,008,952	\$	23,541,918
Adjusted funds from operations(5)		48,991,867		58,262,139		95,421,635		26,959,094		28,073,563
Funds from operations per share, diluted(5)		0.92		0.86		1.83		0.58		0.87
Adjusted funds from operations per share, diluted(5)		0.79		1.14		1.89		0.63		1.03

(1) The information presented for 2016 includes the operating results and financial data of the Acquisition, which was completed on July 14, 2016. See Note 22 Segment Information for additional details of the operating results and financial data pertaining to the Agency Business acquired.

(2) Excluding the impact of a \$58.1 million non-cash net gain on the sale of an equity interest in 2014, basic and diluted income per share for the year ended December 31, 2014 would have each been \$0.55.

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- (3) In 2009, we issued one million warrants as part of a debt restructuring which had a dilutive effect for the years ended December 31, 2013 and 2012. In 2014, we acquired and cancelled all of the warrants.
- (4) Loan sales were \$1.91 billion for 2016, including loans that were acquired as part of the Acquisition.
- (5) See Non-GAAP Financial Measures below for definitions and calculations of funds from operations and adjusted funds from operations.

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**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*You should read the following discussion in conjunction with the sections of this report entitled "Risk Factors," "Forward-Looking Statements," and "Selected Financial Data," along with the historical consolidated financial statements of Arbor Realty Trust, Inc. and Subsidiaries, including related notes, included in this report.*

**Overview**

We invest in a diversified portfolio of structured finance assets in the multifamily and commercial real estate markets, primarily consisting of bridge and mezzanine loans, including junior participating interests in first mortgages, preferred and direct equity, which we refer to as our Structured Business. As a result of the Acquisition, we also now originate, sell and service a range of multifamily finance products through GSE, HUD and CMBS programs. We retain the servicing rights and asset management responsibilities on substantially all loans we originate and sell under the GSE and HUD programs. We refer to our activities we engage in as a result of the Acquisition as our Agency Business. See Note 1 Description of Business for additional details about our business segments and Note 3 Acquisition of Our Manager's Agency Platform for further details about the Acquisition. We organize and conduct our operations to qualify as a REIT. A REIT is generally not subject to federal income tax on its REIT taxable income that is distributed to its stockholders, provided that at least 90% of its REIT taxable income is distributed and provided that certain other requirements are met.

Our operating performance is primarily driven by the following factors:

***Net interest income earned on our investments.*** Net interest income represents the amount by which the interest income earned on our assets exceeds the interest expense incurred on our borrowings. If the yield on our assets increases or the cost of borrowings decreases, this will have a positive impact on earnings. However, if the yield earned on our assets decreases or the cost of borrowings increases, this will have a negative impact on earnings. Net interest income is also directly impacted by the size and performance of our asset portfolio. We recognize the bulk of our net interest income from our Structured Business. Additionally, we recognize net interest income from loans originated through our Agency Business, which are generally sold within 60 days of origination.

***Fees and other revenue recognized from originating, selling and servicing mortgage loans through the GSE and HUD programs.*** Revenue recognized from the origination and sale of mortgage loans consists of commitment fees, broker fees, loan assumption fees, loan origination fees and gains on sale of loans, net of any direct loan origination costs incurred. These fees and gains are collectively referred to as gain on sales, including fee-based services, net. We record income from MSRs at the time of commitment to the borrower, which represents the fair value of the expected net future cash flows associated with the rights to service mortgage loans that we originate, with the recognition of a corresponding asset upon sale. We also record servicing revenue which consists of fees received for servicing mortgage loans, net of amortization on the MSR assets recorded. These origination, selling and servicing fees and other revenue began in the third quarter as a result of the Acquisition and are included in our Agency Business results. Although we (through our Manager) have long-established relationships with the GSE and HUD agencies, our operating performance would be negatively impacted if our business relationships with these agencies deteriorate.

***Income earned from our structured transactions.*** Our structured transactions are primarily comprised of investments in equity affiliates, which represent unconsolidated joint venture investments formed to acquire, develop and/or sell real estate-related assets. Income from these investments comprised a significant portion of our operating results during 2015 and 2016. Our joint venture investment in a residential mortgage banking business currently comprises the majority of income recognized from equity affiliates. If interest rates rise significantly in the future, it is likely that income

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from this investment will significantly decrease. In addition, we periodically receive distributions from our equity investments. It is difficult to forecast the timing of such payments, which can be substantial in any given quarter. We account for our structured transactions within our Structured Business.

**Credit quality of our loans and investments, including our servicing portfolio.** Effective portfolio management is essential to maximize the performance and value of our loan and investment and servicing portfolios. Maintaining the credit quality of the loans in our portfolios is of critical importance. Loans that do not perform in accordance with their terms may have a negative impact on earnings and liquidity.

**Significant Developments During 2016**

**Acquisition of our Manager's Agency Business.** On July 14, 2016, we completed the Acquisition of our Manager's Agency Business for an aggregate purchase price of \$275.8 million. The closing price of our common stock on the Acquisition date was \$7.29 per share; therefore, the estimated fair value of the total consideration given to our Manager approximated \$292.5 million. In connection with the Acquisition, we entered into a \$50.0 million preferred equity interest financing agreement with our Manager to finance a portion of the aggregate purchase price. Total revenues and pre-tax income of the Agency Business from the date of Acquisition, which is included in the consolidated statements of income for 2016, were \$85.6 million and \$41.8 million, respectively. We incurred legal and advisory fees totaling \$10.3 million during 2016 in connection with the Acquisition. As a result of the Acquisition, we now evaluate our results of operations from two business segments: our Structured Business and our Agency Business. See Note 3 Acquisition of Our Manager's Agency Platform and Note 22 Segment Information for additional details of the Acquisition and segments.

**Capital Markets Activity.** The following significant activity occurred during 2016:

In October 2016, we issued \$86.3 million aggregate principal amount of 6.50% convertible senior unsecured notes which mature on October 1, 2019 for net proceeds of \$82.4 million;

In August 2016, we amended the equity distribution agreement with JMP Securities LLC under which we may offer and sell up to 7,500,000 common shares in "At-The-Market" equity offerings with JMP Securities. We have not sold any shares under this agreement during 2016; and

In July 2016, we filed, and the SEC declared effective, a new shelf registration statement for \$500.0 million of debt securities, common stock, preferred stock, depositary shares and warrants.

**Dividend.** We raised our quarterly common dividend to \$0.17 per share in the first quarter of 2017, a 13% increase over the quarterly common dividend paid in the prior year comparable quarter of \$0.15 per share.

**Agency Business Activity.** The following significant activity occurred during 2016:

Loan originations from the Acquisition date (July 14, 2016) totaled \$2.15 billion;

Loan sales from the Acquisition date totaled \$1.49 billion, excluding \$418.2 million of sales on loans that were acquired as part of the Acquisition; and

Our servicing portfolio grew from \$11.94 billion at the Acquisition date to \$13.56 billion at December 31, 2016, a 14% increase since we acquired the servicing portfolio in July 2016.

**Structured Business Activity.** The following significant activity occurred during 2016:

*Loan and Investment Activity*

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Our loan and investment portfolio grew 17% through loan originations that totaled \$847.7 million with a weighted average interest rate of 6.74%;

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Loan runoff was \$553.4 million comprised of payoffs totaling \$515.6 million with a weighted average interest rate of 7.03% and partial paydowns totaling \$37.8 million with a weighted average interest rate of 6.18%;

We recognized income from equity investments totaling \$13.0 million, primarily comprised of \$9.5 million from our interest in a residential mortgage banking business and \$2.8 million of cash distributions received from one of our equity investments. Through our investment in a joint venture that invests in non-qualified residential mortgages, we funded \$5.9 million of mortgage purchases and received cash distributions totaling \$13.0 million from the sale of mortgage assets, which was classified as a return of capital;

During 2016, we sold most of the remaining real estate owned assets, including three multifamily properties and a hotel property for a total of \$50.7 million, recognizing gains totaling \$11.6 million. We used the proceeds from the multifamily sale to payoff the \$27.1 million outstanding debt on these properties. In addition, we recorded an impairment loss of \$11.2 million on the remaining hotel property we own as a result of an impairment analysis performed in the second quarter; and

In April 2016, additional funds held in escrow from a defaulted first mortgage that paid off were released following an arbitration proceeding and we recognized income totaling \$1.9 million, net of fees and expenses. The \$1.9 million of income consisted of other interest income totaling \$2.5 million, partially offset by \$0.6 million of expenses, which were recorded in employee compensation and benefits. See Note 4 Loans and Investments for additional details.

*Financing Activity*

In December 2016, we completed the unwinding of a collateralized securitization vehicle ("CLO III"), redeeming \$281.3 million of outstanding notes which were repaid primarily from refinancing of the remaining assets within our financing facilities and other CLOs, as well as with cash held by CLO III, and expensed \$1.0 million of deferred fees into interest expense;

In September 2016, we entered into a three-year \$50.0 million credit facility to finance first mortgage loans on healthcare facilities that bears interest at rates ranging from 250 basis points to 325 basis points over LIBOR, depending on the type of healthcare facility financed, and matures in September 2019 with two one-year extension options; and

In August 2016, we closed our sixth collateralized securitization vehicle ("CLO VI") totaling \$325.0 million of real estate related assets and cash, of which \$250.3 million of investment-grade notes were issued and a \$74.8 million equity interest in the portfolio was retained by us.

**Subsequent Events.** The following significant activity occurred subsequent to December 31, 2016:

In January 2017, we issued an additional \$13.8 million of the 6.50% convertible senior unsecured notes under the same terms as the original issuance in October 2016, which increased the aggregate outstanding principal amount to \$100.0 million. We received net proceeds of \$13.4 million from this additional offering; and

In February 2017, we purchased, at a discount, \$20.9 million of our junior subordinated notes with a carrying value of \$19.9 million and expect to record a gain on extinguishment of debt of approximately \$7.2 million in the first quarter of 2017.

**Current Market Conditions, Risks and Recent Trends**



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Our ability to execute our business strategy, particularly the growth of our Structured Business portfolio of loans and investments, is dependent on many factors, including our ability to access capital and financing on favorable terms. The previous economic downturn that occurred in 2007 through 2010

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had a significant negative impact on both us and our borrowers. If similar economic conditions recur in the future, it may limit our options for raising capital and obtaining financing on favorable terms and may also adversely impact the creditworthiness of our borrowers which could result in their inability to repay their loans.

We rely on the capital markets to generate capital for financing the growth of our Structured Business. During 2016, we closed a new collateralized securitization offering, whereby we issued \$250.3 million of investment-grade notes and entered into a new \$50.0 million financing facility. We also issued \$86.3 million aggregate principal amount of 6.50% convertible senior unsecured notes. In January 2017, we issued an additional \$13.8 million of the convertible senior notes. While there can be no assurance that we will continue to have access to the equity and debt markets, we will continue to pursue these and other available market opportunities as a means to increase our liquidity and capital base. If we were to experience another prolonged downturn in the stock or credit markets, it could cause us to seek alternative sources of potentially less attractive financing, and may require us to adjust our business plan accordingly.

As a result of the Acquisition, we are now a national originator with Fannie Mae and Freddie Mac, and the GSEs remain the most significant providers of capital to the multifamily market. The FHFA 2017 Scorecard established Fannie Mae's and Freddie Mac's 2017 Caps at \$36.5 billion each for the multifamily finance market, no change from the 2016 loan origination caps. Affordable housing loans, loans to small multifamily properties, and manufactured housing rental community loans continue to be excluded from the 2017 Caps. Additionally, the definition of the affordable loan exclusion continues to encompass affordable housing in high-and very-high cost markets and allows for an exclusion from the 2017 Caps for the pro-rata portion of any loan on a multifamily property that includes affordable units. The 2017 Scorecard provides FHFA the flexibility to review the estimated size of the multifamily loan origination market on a quarterly basis and proactively adjust the 2017 Caps upward should the market be larger than expected. In fact, in 2016, the caps were increased by \$5.5 billion to \$36.5 billion by year end. The 2017 Scorecard also provides exclusions for loans to properties in underserved markets including rural, small multifamily and senior assisted living and for loans to finance energy or water efficiency improvements. Our originations with the GSEs are highly profitable executions as they provide significant gains from the sale of our loans and non-cash gains related to MSR's. A decline in our GSE originations would negatively impact our financial results as non-cash revenues would decrease disproportionately with loan origination volume and future servicing fee revenue would be constrained or decline. We do not know whether the FHFA will impose stricter limitations on GSE multifamily production volume in the future.

The Federal Reserve raised its targeted Fed Funds Rate by 25 basis points during the fourth quarter of 2016. To date we have not been significantly impacted by this increase and do not anticipate a significant decline in origination volume or profitability as a result of the increase as interest rates remain at historically low levels. However, we cannot be certain that such a trend will continue as the number, timing, and magnitude of additional increases by the Federal Reserve, combined with other macroeconomic factors, may have a different effect on the commercial real estate market.

The commercial real estate markets continue to improve, but uncertainty remains as a result of global market instability, the current political climate and other matters and their potential impact on the U.S. economy and commercial real estate markets. In addition, the growth in multifamily rental rates seen over the past few years are showing signs of stabilizing. If real estate values decline again and/or rent growth subsides, it may limit our new mortgage loan originations since borrowers often use increases in the value of, and revenues produced from, their existing properties to support the purchase or investment in additional properties. Declining real estate values may also significantly increase the likelihood that we will incur losses on our loans in the event of default because the value of our collateral may be insufficient to cover our cost on the loan. Any sustained period of increased payment delinquencies, foreclosures or losses could adversely affect both our net interest income from loans as

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well as our ability to originate, sell and securitize loans, which would significantly impact our results of operations, financial condition, business prospects and our ability to make distributions to our stockholders.

The economic environment over the past few years has seen continued improvement in commercial real estate values, which has generally increased payoffs and reduced the credit exposure in our loan and investment portfolio. We have made, and continue to make, modifications and extensions to loans when it is economically feasible to do so. In some cases, a modification is a more viable alternative to foreclosure proceedings when a borrower cannot comply with loan terms. In doing so, lower borrower interest rates, combined with non-performing loans, would lower our net interest margins when comparing interest income to our costs of financing. However, since 2013, the levels of modifications and delinquencies have generally declined as property values increase and borrowers' access to financing has improved. If the markets were to deteriorate and another prolonged economic downturn was to occur, we believe there could be additional loan modifications and delinquencies, which may result in reduced net interest margins and additional losses throughout our sector.

**Changes in Financial Condition**

*Assets Comparison of balances at December 31, 2016 to December 31, 2015:*

Cash and cash equivalents decreased \$50.1 million, primarily due to net cash consideration paid in connection with the Acquisition, funding new loan originations and investments, distributions from unwinding CLO III, along with payment of distributions to our stockholders, partially offset by loan payoffs, proceeds from convertible notes, transferring loans into our CLO vehicles, property sales and interest from our investments.

Restricted cash decreased \$32.1 million, excluding the restricted cash of \$13.1 million from the Agency Business acquired, primarily due to the transfer of loans into our CLO vehicles and distributions from unwinding CLO III, partially offset by payoffs and paydowns on our CLO loans and issuance proceeds available from CLO VI. Restricted cash is kept on deposit with the trustees for our CLOs and primarily represents proceeds received from loan payoffs and paydowns that have not yet been disbursed to bondholders or redeployed into new assets, as well as unfunded loan commitments and interest payments received from loans. The restricted cash from the Agency Business acquired represents the cash collateral for possible losses resulting from the loans originated under the Fannie Mae DUS program in accordance with the terms of the loss-sharing agreements.

Our loan and investment portfolio balance from our Structured Business was \$1.80 billion and \$1.56 billion at December 31, 2016 and 2015, respectively. This increase was primarily due to loan originations exceeding loan payoffs and other reductions by \$294.3 million, see below for details.

Our portfolio had a weighted average current interest pay rate of 5.71% and 5.63% at December 31, 2016 and 2015, respectively. Including certain fees and costs associated with the loan and investment portfolio, the weighted average current interest rate was 6.39% and 6.32% at December 31, 2016 and 2015, respectively. Advances on our financing facilities totaled \$1.35 billion and \$1.18 billion at December 31, 2016 and 2015, respectively, with a weighted average funding cost of 3.91% and 3.70%, respectively, which excludes changes in the market value of certain interest rate swaps and financing costs. Including the financing costs, the weighted average funding rate was 4.45% and 4.12%

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at December 31, 2016 and 2015, respectively. Activity from our Structured Business portfolio was comprised of the following:

	Year Ended December 31,	
	2016	2015
Loans originated	\$ 847,682,500	\$ 828,217,500
Number of loans	70	70
Weighted average interest rate	6.74%	6.87%
Loans paid-off	\$ 515,612,734	\$ 716,154,152
Number of loans	45	66
Weighted average interest rate	7.03%	6.90%
Loans partially paid-off	\$ 37,796,000	\$ 112,515,404
Number of loans	9	16
Weighted average interest rate	6.18%	5.08%
Loans extended	\$ 569,134,421	\$ 274,350,887
Number of loans	51	41

Our loans held-for-sale, net from the Agency Business was \$673.4 million at December 31, 2016, which represents commercial mortgages originated through the Fannie Mae, Freddie Mac and HUD programs. These loans are generally sold within 60 days from the loan origination date. Loan and investment activity from our Agency Business for 2016 was comprised of the following:

	Loan Originations	Loan Sales(1)
Fannie Mae	\$ 1,668,581,271	\$ 1,130,391,796
Freddie Mac	456,421,660	332,319,660
FHA	24,629,823	29,672,932
Total	\$ 2,149,632,754	\$ 1,492,384,388

(1) Excludes \$418.2 million of sales on loans that were acquired on July 14, 2016 as part of the Acquisition.

Since December 31, 2016, our Structured Business originated 9 new loans totaling \$86.3 million and received a total of \$63.7 million for the repayment of 6 loans. The Agency Business originated 91 new loans totaling \$641.7 million and sold 133 loans totaling \$1.00 billion.

Our capitalized mortgage servicing rights, net from the Agency Business acquired was \$227.7 million at December 31, 2016, which represents the estimated value of our rights to service mortgage loans for others. The weighted average estimated life remaining of our MSRs was approximately 6.9 years at December 31, 2016.

Investments in equity affiliates increased \$3.1 million, primarily due to income of \$9.5 million recognized from our investment in a residential mortgage banking business and an additional \$5.9 million contribution made in our investment in non-qualified residential mortgages. These increases were substantially offset by cash distributions totaling \$13.0 million received from our non-qualified residential mortgage investment as a result of the joint venture selling most of its mortgage assets, which were classified as a return of capital.

Our real estate owned assets (owned and held-for-sale) decreased \$50.0 million, primarily from selling three multifamily properties and a hotel property with an aggregate carrying value of \$37.3 million and recording an \$11.2 million impairment on a hotel property.

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We recorded intangible assets totaling \$73.3 million and goodwill of \$26.7 million in connection with the Acquisition. Of the intangible asset total, \$44.3 million represents finite-lived assets that will be amortized over the estimated useful lives of such assets, which was estimated to be 8.4 years at the Acquisition date.

Other assets increased \$18.6 million, primarily from assets acquired in the Acquisition.

***Liabilities Comparison of balances at December 31, 2016 to December 31, 2015:***

Credit facilities and repurchase agreements increased \$110.2 million, excluding credit facilities totaling \$660.1 million related to the Agency Business. The increase was primarily due to funding of new loan activity. The Agency Business credit facilities are used to fund loans that are originated through the GSE and HUD programs and are primarily secured by our loans held-for-sale, which are generally sold within 60 days from loan origination.

Collateralized loan obligations decreased \$30.5 million due to the unwind of CLO III totaling \$281.3 million, substantially offset by the issuance of CLO VI, where we issued \$250.3 million of CLO notes.

In the fourth quarter of 2016, we issued \$86.3 million aggregate principal amount of 6.50% convertible senior unsecured notes for net proceeds of \$82.4 million. The principal amount, net of deferred financing fees, recorded as a liability was \$80.2 million and the remaining \$2.2 million was allocated to the conversion feature and recorded as a component of additional paid-in capital. See Note 12 Debt Obligations for additional details.

Mortgage note payable real estate owned decreased \$27.2 million, due to the pay-off of these notes with the proceeds from the sale of the remaining multifamily properties.

In connection with the Acquisition, we entered into a \$50.0 million preferred equity interest financing agreement with our Manager to finance a portion of the purchase price. See Note 12 Debt Obligations.

Due to borrowers increased \$46.4 million, due to an increase in funds held on loan originations.

We assumed an allowance for loss-sharing in connection with the Acquisition. We maintain this allowance to satisfy our obligation to partially guarantee the performance of the agency loans sold under the Fannie Mae DUS program. Generally, we are responsible for losses equal to the first 5% of the UPB and a portion of any additional losses to an overall maximum of 20% of the original principal balance. At December 31, 2016, this allowance was \$32.4 million.

Other liabilities increased \$35.1 million, primarily from the liabilities assumed with the Acquisition, which is comprised mostly of accrued compensation costs and a deferred tax liability.

***Equity***

In connection with the Acquisition, we issued 21,230,769 OP Units to our Manager to satisfy a portion of the purchase price. The value of these OP units at the date of Acquisition was \$154.8 million. Each of these OP Units are paired with one share of our Special Voting Preferred Shares having a par value of \$0.01 per share and is entitled to one vote each on any matter submitted for stockholder approval. The value of the OP Units are reflected as noncontrolling interest in the consolidated balance sheets.

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The following table presents dividends declared (on a per share basis) for 2016:

Common Stock		Preferred Stock			
Declaration Date	Dividend	Declaration Date	Series A	Dividend(1)	
				Series B	Series C
February 24, 2016	\$ 0.15	February 1, 2016	\$ 0.515625	\$ 0.484375	\$ 0.53125
May 4, 2016	\$ 0.15	May 2, 2016	\$ 0.515625	\$ 0.484375	\$ 0.53125
August 3, 2016	\$ 0.16	August 1, 2016	\$ 0.515625	\$ 0.484375	\$ 0.53125
November 2, 2016	\$ 0.16	November 2, 2016	\$ 0.515625	\$ 0.484375	\$ 0.53125

(1)

The dividend declared on February 1, 2016 was for December 1, 2015 through February 29, 2016. The dividend declared on May 2, 2016 was for March 1, 2016 through May 31, 2016. The dividend declared on August 1, 2016 was for June 1, 2016 through August 31, 2016. The dividend declared on November 2, 2016 was for September 1, 2016 through November 30, 2016.

*Common Stock* On March 1, 2017, the Board of Directors declared a cash dividend of \$0.17 per share of common stock. The dividend is payable on March 21, 2017 to common stockholders of record as of the close of business on March 15, 2017.

*Preferred Stock* On February 3, 2017, the Board of Directors declared a cash dividend of \$0.515625 per share of 8.25% Series A preferred stock; a cash dividend of \$0.484375 per share of 7.75% Series B preferred stock; and a cash dividend of \$0.53125 per share of 8.50% Series C preferred stock. These amounts reflect dividends from December 1, 2016 through February 28, 2017 and are payable on February 28, 2017 to preferred stockholders of record on February 15, 2017.

*Deferred Compensation*

We issued 352,630 shares of restricted stock to employees of ours and our Manager, including our chief executive officer, 67,260 shares to the independent members of the Board of Directors and up to 421,348 performance-based restricted common stock units to our chief executive officer in the first quarter of 2016. See Note 18 Equity for additional details.

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**Comparison of Results of Operations for Years Ended 2016 and 2015**

The following table provides our consolidated operating results:

	Year Ended December 31,		Increase/(Decrease)	
	2016	2015	Amount	Percent
Interest income	\$ 116,172,621	\$ 106,768,542	\$ 9,404,079	