Accredited Mortgage Loan REIT Trust
Form 10-K
March 16, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2005

or

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

For the transition period from ______ to ______

Commission File Number 0-50179

ACCREDITED MORTGAGE LOAN REIT TRUST

(Exact name of registrant as specified in its charter)

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

15090 Avenue of Science

San Diego, California 92128

(Address of principal executive offices) (Zip Code)

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

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

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

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

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

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

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

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

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

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer x

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

As of June 30, 2005 none of Accredited Mortgage Loan REIT Trust s voting or non-voting common equity was held by non-affiliates.

The number of outstanding shares of the registrant s common stock as of March 10, 2006 was 100,000.

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INCORPORATION BY REFERENCE

Portions of the registrant s Definitive Proxy Statement to be filed with the Commission pursuant to Regulation 14A in connection with the registrant s 2006 Annual Meeting of Shareholders, subsequent to the date hereof, are incorporated by reference into Parts II and III of this Report. Such Definitive Proxy Statement will be filed with the Securities and Exchange Commission not later than 120 days after the conclusion of the registrant s fiscal year ended December 31, 2005.

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EXPLANATORY NOTE

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

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FORWARD-LOOKING STATEMENTS

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

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

- an increase in mortgage loan payment default rates due to a general deterioration in economic or political conditions, fluctuations in the real estate markets, an increase in unemployment rates, and/or an increase in interest rates that results in higher loan payment amounts for the borrower;
- a decline in interest income due to a decrease in the difference between our cost of capital and the income generated by payments on our securitized mortgage loan pools;
- changes in demand for mortgage backed securities that affect our ability to issue notes to fund our securitizations;
- our ability to protect and hedge our mortgage loan portfolio against adverse interest rate movements;
- our ability to maintain status as a real estate investment trust and the corresponding tax treatment;
- the degree and nature of AHL s competition that may impact the value of the loans originated by AHL;
- a change in the financial stability of Accredited, which guarantees the dividend payments on our 9.75% Series A Perpetual Cumulative Preferred Shares (Series A Preferred Shares);
- an increase in the rate of prepayments on securitized mortgage loans that could reduce the amount of cash flow distributed to us in respect of excess interest;
- the other factors referenced in this report, including, without limitation, under the sections entitled ITEM 7. Management s Discussion and Analysis of Financial Condition and Results of Operations, and ITEM 1B. Risk Factors and Accredited s Guarantee of Our Series A Preferred Shares.

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

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

PART I

ITEM 1. Business

General Development of Our Business

Accredited Mortgage Loan REIT Trust is a Maryland real estate investment trust that was created for the purpose of acquiring, holding and managing real estate assets that are intended to generate net income for distribution to our shareholders. Our assets primarily consist of pools of securitized mortgage loans that we have securitized in structures that require financing treatment. The securitizations are legally structured as sales, but for accounting purposes are treated as financings. All of our outstanding common shares are owned by AHL. We intend to elect to be subject to tax as a real estate investment trust under the Internal Revenue Code and will generally not be subject to federal or state income tax to the extent that we distribute our earnings to our shareholders and maintain our qualification as a real estate investment trust. We completed a public offering of our 9.75% Series A Perpetual Cumulative Preferred Shares (Series A Preferred Shares) in August 2004 and our preferred shares became listed at that time on the New York Stock Exchange under the symbol AHH PrA.

As discussed in Note 1 to the consolidated financial statements, we acquire mortgage assets and assume related funding obligations from AHL, who also provides operating facilities, administration and servicing for us. We are, therefore, economically and operationally dependent on AHL, and, as such, our results of operation or financial condition would not be indicative of the conditions that would have existed for our results of operations or financial condition if we had operated as an unaffiliated entity.

Description of Our Business

General

Our principal business objective is to acquire, hold and manage mortgage assets that will generate net income for distribution to our shareholders. In order to preserve our status as a real estate investment trust under the Internal Revenue Code, substantially all of our assets will consist of retained interests and other qualified real estate investment trust real estate assets of the type set forth in Section 856(c)(5)(B) of the Internal Revenue Code.

Acquisition of Real Estate Investment Trust Assets

Generally, we acquire our mortgage assets as contributions of capital from our direct parent, AHL. These mortgage assets consist primarily of residential mortgage loans, or interests in these mortgage loans, that have been originated or acquired by AHL. These contributions of mortgage assets from AHL are effected in two ways:

First, AHL from time to time transfers to us, as contributions of capital, portfolios of mortgage loans to be securitized.

Second, AHL transferred to us, as contributions of capital, interests in mortgage pools, which had already been securitized by AHL.

AHL focuses on borrowers who may not meet conforming underwriting guidelines because of higher loan-to-value (LTV) ratios, the nature or absence of income documentation, limited credit histories, high levels of consumer debt, or past credit difficulties. AHL originates loans primarily based upon the borrower s willingness and ability to repay the loan and the adequacy of the collateral.

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Mortgage-backed securitizations

We execute securitizations of residential mortgage loans that have been originated or acquired by AHL. In these transactions, AHL transfers a pool of mortgage loans to us as a contribution of capital. The mortgage loans are transferred subject to the lien of one or more of AHL s creditors that provide financing for loan originations or acquisitions. These creditors are commonly referred to as warehouse lenders. We then sponsor a securitization trust, and transfer the mortgage loans to the securitization trust, which is a wholly-owned subsidiary of ours. The securitization trust then pledges the mortgage loans to secure notes which are then issued, and underwritten or privately-placed and sold to third-party investors. The net proceeds of the securitization are used by us to repay the warehouse debt and pay other expenses of the securitization. As the certificate holder of the securitization trust, we are entitled to receive distributions of cash flow, if any, generated by the related mortgage loans, to the extent that the cash flow is not needed to service the notes or pay securitization expenses. We refer to the right to receive this cash flow as the retained interest in the securitization.

The prior securitizations executed by AHL and us have been structured legally as sales, but for accounting purposes they were structured as financings. Therefore, while the related securitization trust is the legal owner of the pool of securitized mortgage loans and is the obligor on the securitization notes, for accounting purposes, both the securitized mortgage loans and the securitization indebtedness appear as assets and liabilities, respectively, on our balance sheet.

During 2005 and 2004, we completed a total of four and three securitizations, respectively, structured as financings totaling $4.2 billion and $2.8 billion, respectively.

Dividend Policy

In order to remain qualified as a real estate investment trust, we must distribute annually at least 90% of our real estate investment trust taxable income (excluding capital gains) to shareholders. Dividends will be declared at the discretion of our board of trustees out of assets legally available to make such payments, after considering our distributable funds, financial requirements, tax considerations and other factors.

Our distributable funds consist primarily of distributions on the retained interests held by us. While we expect that the distributions on the retained interests will be sufficient to support the payment of dividends, these distributions are subject to considerable uncertainty. Accordingly, under certain circumstances, including periods in which the mortgage pools experience significant prepayments or realized losses, we may experience a decrease in income available to be distributed to our shareholders. Consequently, significant prepayments or realized losses could have an adverse effect on our ability to pay dividends on our Series A Preferred Shares.

General Description of REIT s Assets; Investment Policy

Retained Interests

Each retained interest owned by us represents ownership of the related securitization trust and the right to receive excess cash flow generated by the trust. This excess cash flow is derived from two sources: excess interest and return of over-collateralization.

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

Excess interest

Excess interest, if any, consists of interest collections on the related mortgage loans each month after (i) payment of related administrative fees, reimbursements and expenses, including servicing fees, backup

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servicing fees, trustee fees and expenses and insurer premium, and reimbursements and indemnification of the trustee and the insurer and (ii) payment of required distributions to holders of the related underlying notes.

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

Principal

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

Over-Collateralization

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

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

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

As described below under The Mortgage Pools , prepayments of principal and realized losses on the related mortgage loans will reduce the aggregate outstanding principal balance of such mortgage loans and therefore will reduce the aggregate amount of excess interest that could be generated by the mortgage loans. The aggregate amount of excess interest generated by the mortgage loans in a mortgage pool will decrease more significantly as a result of principal payments and realized losses on those mortgage loans with relatively high interest rates. If prepayments or liquidations occur with more frequency on mortgage loans in a mortgage pool having relatively higher interest rates than on mortgage loans in a mortgage pool having relatively lower interest rates, and the foregoing results in any of the related notes having their interest rate limited by any applicable available funds cap rate, then no excess interest will be generated by the portion of the aggregate principal balance of such mortgage loans equal to the principal balance of such class of notes. Reductions of the amount of

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excess interest generated by the mortgage loans in a mortgage pool will in turn reduce the aggregate amount of distributions on the related retained interests. In addition, the notes may be entitled to recover the amount of interest not paid on such classes because of the application of the applicable available funds cap rate, which may result in a reduction of the amount of excess interest that could be included among the amounts that may remain available for distribution to the holders of the retained interests.

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

The Mortgage Pools

The mortgage loans in each mortgage pool were originated or purchased by AHL and consist of fixed- and adjustable-rate first lien residential mortgage loans in accordance with AHL s underwriting guidelines and policies. The mortgage loans were transferred and assigned by AHL or us to the related securitization trust.

The distributions received by us in respect of the retained interests will depend, in general, upon the performance of the underlying mortgage pool, including:

- the rate and timing of principal payments (including prepayments and collections upon defaults, liquidations of the mortgage loans, and payment of any related prepayment charges) and realized losses on the mortgage loans;

- adjustments of the interest rates of the underlying notes that bear interest at an adjustable rate and adjustments of the interest rates of the adjustable-rate mortgage loans;

- whether or not the clean-up call (seller s option to terminate the trust when notes are 10% or less of original balance) occurs; and

- whether an event of default occurs under the related indenture.

Each prepayment or liquidation of a mortgage loan will extinguish the excess interest with respect to the mortgage loan. Accordingly, if a securitization trust experiences rapid prepayments or a significant increase of defaults of related mortgage loans (and, in particular, defaults or prepayments on higher coupon mortgage loans), the excess interest generated in the securitization trust can be significantly eroded and in extreme cases extinguished. Excess cash flow can also be significantly reduced if there is a significant upward adjustment in the interest rate index (One-Month LIBOR) of the underlying notes in relation to the rate of interest borne by the related mortgage loans.

Certain factors may influence prepayments and defaults, including interest rate fluctuations, origination and underwriting standards, loan-to-value ratios and delinquency history. The rate and timing of prepayments and defaults on the mortgage loans will be affected by the general economic condition of the area in which the related mortgaged properties are located or the related mortgagor is residing. The risk of delinquencies and losses is greater and voluntary principal prepayments are less likely in regions where a weak or deteriorating economy exists, as may be evidenced by, among other factors, increasing unemployment or falling property values. In addition, defaults and voluntary prepayments of the mortgage loans may be influenced by changes in the mortgagors housing needs, unemployment of the mortgagor, employment relocation, servicing decisions, homeowner mobility, the existence and enforceability of due on sale clauses or prepayment charges, seasoning of the mortgage loans and market interest rates for similar types of mortgage loans.

Management Policies and Programs

Asset Acquisition and Disposition Policies

We anticipate that from time to time we will obtain additional mortgage assets. We intend to acquire all or substantially all of these mortgage assets from AHL as a contribution of additional capital. We currently anticipate that the mortgage assets that we obtain will principally consist of assets eligible to be held by real estate investment trusts. We currently anticipate that AHL will service the mortgage loans during the period of time the loans are owned by us prior to securitization in a manner consistent with secondary market standards.

Capital and Leverage Policies

To the extent that our board of trustees determines that additional funding is required by us, we may raise these funds through additional equity offerings, debt financing or retention of cash flow (after consideration of provisions of the Internal Revenue Code requiring the distribution by a real estate investment trust of a certain percentage of taxable income and taking into account taxes that would be imposed on undistributed taxable income), or a combination of these methods.

We do not currently intend to incur any significant indebtedness other than securitization bond financing and warehouse credit facility financing. However, our organizational documents do not contain any limitation on the amount or percentage of debt, funded or otherwise, that we might incur.

In connection with our execution of securitization transactions, we may enter into warehouse transactions with lenders to finance the related mortgage loan pool during the period of time that we own the mortgage loans prior to securitization. AHL may agree to guarantee our obligations under the interim warehouse. In addition, we may also agree to guarantee the indebtedness of AHL under any outstanding warehouse line that AHL may have with that warehouse lender. The indebtedness of AHL, on one hand, and our indebtedness, on the other hand, may provide that a default under the obligations of one of the borrowers constitutes a default of the other borrower, and that the mortgage loans pledged to secure the obligations of one borrower also constitute security against the borrowings of the other borrower. We presently contemplate along with AHL that any such guarantee by us will expire upon repayment of its interim warehouse line.

Credit Risk Management Policies

We intend that each mortgage loan that we acquire from AHL for securitization will be originated in the ordinary course of AHL s real estate lending activities based on the underwriting standards generally applied at the time of origination for AHL s own account. We intend to execute securitization transactions composed of these portfolios of mortgage loans, and we do not currently plan to hold mortgage loans directly for any extended period of time. We may choose, at any time subsequent to our acquisition of retained interests, to dispose of any retained interest for any reason, including as a result of the deterioration of the underlying mortgage pool.

Conflict of Interest Policies

Because of the nature of our relationship with Accredited and AHL, it is likely that conflicts of interest will arise with respect to certain transactions, including without limitation, our acquisition of mortgage assets from, or disposition of mortgage assets to, Accredited or AHL and in the execution of securitization transactions. It is our policy that the terms of any financial dealings with Accredited or AHL will be consistent with those available from third parties in the mortgage lending industry.

Conflicts of interest between us and Accredited and AHL may also arise in connection with making decisions that bear upon the credit arrangements that Accredited or AHL may have with a borrower. Conflicts could also arise in connection with actions taken by AHL as a controlling person in us. It is our intention and the intention of AHL and Accredited that any agreements and transactions between us, on the one hand, and Accredited and AHL, on the other hand, are fair to all parties and are consistent with market terms for such types of transactions. There can be no assurance that any such agreement or transaction will be on terms as favorable to us as would have been obtained from unaffiliated third parties.

There are no provisions in our Declaration of Trust limiting any of our officers, trustees, security holders or affiliates from having any direct or indirect pecuniary interest in any mortgage asset to be acquired or disposed of by us or in any transaction in which we have an interest or from engaging in acquiring, holding and managing mortgage assets. As described in this Annual Report on Form 10-K, it is expected that Accredited and AHL will have direct interests in transactions with us (including without limitation the contribution of mortgage assets to us and the servicing of the mortgage loans by AHL); however, it is not currently anticipated that any of our officers or trustees will have any interests in these mortgage assets.

Other Policies

We intend to operate in a manner that will not subject us to regulation under the Investment Company Act of 1940, as amended (the Investment Company Act), in order to satisfy the requirements for exemptive relief from regulation under the Investment Company Act, we may be subject to restrictions on our operations, including on our ability to acquire certain types of mortgage assets.

We may, under certain circumstances, purchase our Series A Preferred Shares in the open market or otherwise. We have no present intention of repurchasing any shares of beneficial interest, and any such action would be taken only in conformity with applicable federal and state laws and the requirements for qualifying as a real estate investment trust.

We currently intend to make investments and operate our business at all times in such a manner as to be consistent with the requirements of the Internal Revenue Code to qualify as a real estate investment trust. However, future economic, market, legal, tax or other considerations may cause our board of trustees, subject to any necessary approval by a majority of the independent trustees, to determine that it is in our best interests and our shareholders best interests to revoke our real estate investment trust status.

Servicing

Our mortgage loans are serviced by AHL both during the time that they are owned by us and after they have been transferred to the related securitization trust. We refer to AHL in its role as servicer is as the Servicer.

The Servicer is required to service the mortgage loans using the same care as it customarily employs in servicing and administering mortgage loans for its own account, in accordance with accepted mortgage servicing practices of prudent lending institutions. The Servicer collects and remits principal and interest payments, administers mortgage escrow accounts, submits and pursues insurance claims and initiates and supervises foreclosure proceedings on the mortgage loans it services. The Servicer also provides accounting and reporting services for these mortgage loans. The Servicer follows such collection procedures as are customary in the industry, including contacting delinquent borrowers and supervising foreclosures and property disposition in the event of un-remedied defaults. The Servicer may, in its discretion, arrange with a defaulting borrower a schedule for the liquidation of delinquencies. The Servicer may from time to time subcontract all or a portion of its servicing obligations to unrelated third parties. The Servicer generally will not, in connection with subcontracting any of its servicing obligations, be discharged or relieved in any respect from its servicing obligations.

The Servicer is required to pay all expenses related to the performance of its duties as servicer. The Servicer is required to make advances of taxes and required insurance premiums that are not collected from borrowers with respect to any mortgage loan serviced by it, unless it determines that these advances are non-recoverable from the mortgagor, insurance proceeds or other sources with respect to the mortgage loan. If such advances are made, the Servicer generally will be reimbursed on a priority basis out of proceeds related to such mortgage loan. The Servicer also will be entitled to reimbursement for expenses incurred by it in connection with the liquidation

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of defaulted mortgage loans serviced by it and in connection with the restoration of mortgaged property. The Servicer may institute foreclosure proceedings, exercise any power of sale contained in any mortgage or deed of trust, obtain a deed in lieu of foreclosure or otherwise acquire title to a mortgaged property underlying a mortgage loan by operation of law or otherwise in accordance with its servicing practices.

Competition

We do not engage in the business of originating mortgage loans. We acquire mortgage assets contributed by AHL. Accordingly, we do not directly compete with mortgage conduit programs, investment banking firms, savings and loan associations, banks, thrift and loan associations, finance companies, mortgage bankers or insurance companies in acquiring our mortgage assets, but could be affected by developments in those markets.

Tax Status

We have elected to be taxed as a REIT under Sections 856 through 860 of the Code. As a REIT, we generally will not be subject to federal income tax on our net income (excluding capital gains) provided that we distribute annually 100% of our taxable income to our shareholders, meet certain organizational, stock ownership and operational requirements and meet certain income and asset tests. To remain qualified as a REIT, we must (a) distribute each year at least 90% of our REIT taxable income (not including net capital gains) for that year to our shareholders, (b) meet certain income tests, (c) meet certain asset tests and (d) meet certain ownership tests. If in any taxable year we fail to qualify as a REIT, we would not be allowed a deduction for distributions to shareholders in computing our taxable income and would be subject to federal and state income tax (including any applicable alternative minimum tax) on our taxable income at regular corporate rates. In addition, we would be disqualified from treatment as a REIT for the four taxable years following the year during which qualification was lost.

There are two income tests that we must satisfy for each taxable year.

- At least 75% of our gross income (excluding income from certain prohibited transactions) must be from interest on obligations secured by mortgages on real property or on interests in real property, gains from the sale or other disposition of real property (including interests in mortgages on real property), and certain other sources; and,

- At least 95% of our gross income (excluding income from prohibited transactions) must be from income included under the 75% income test, other interest, dividends, and gains from the sale or other disposition of certain stocks and securities.

There are three relevant asset tests that must be satisfied by us at the close of each quarter of our taxable year.

- At least 75% of the value of our total assets must be represented by real estate assets, cash, cash items, and government securities;

- Not more than 25% of our total assets may be represented by securities other than those in the 75% asset class; and

The value of any one issuer s securities included in the 25% asset class may not exceed 5% of the value of our total assets and we may not own more than 10% of the total voting power or value of the outstanding securities of any one issuer.

The stock ownership test has two components. At least 100 persons must hold shares of our capital stock for at least 335 days of the year and no more than 50% of our capital stock may be owned directly or indirectly by five or fewer individuals during the last six months of our taxable year.

During 2005, we have met the above requirements.

Employees

We have five executive officers. We do not have any employees beyond our management personnel. Each of our officers is currently also an officer of Accredited. We maintain corporate records that are separate from those of Accredited and Accredited s other affiliates.

Administrative and Servicing Agreement

We are a party to an intercompany administration and servicing agreement with AHL whereby we compensate AHL for loan servicing, treasury, accounting, tax and other administrative services provided by AHL. We pay to AHL a management fee equal to 0.50% per year on the outstanding principal balance of the loans serviced by it, plus miscellaneous fee income collected from mortgagors, including late payment charges, assumption fees and similar items. Under this agreement, either party agrees to pay interest on the net average balance payable at an annual rate equal to the Six-Month LIBOR plus 1.00%.

Executive Officers

Our executive officers and their ages as of December 31, 2005 are as follows:

James A. Konrath, 59, has served as our Chairman of the Board and Chief Executive Officer since REIT s formation in May 2004. Mr. Konrath also co-founded Accredited and has served as the Chairman of the Board and Chief Executive Officer of Accredited since its formation in 1990. In addition, Mr. Konrath served as Accredited s President from 1990 to 1998. Prior to founding Accredited, Mr. Konrath was the President and Chief Executive Officer of Security Pacific Financial Services, Inc., where he managed over 1,900 people in more than 300 consumer finance offices, from 1986 to 1989. From 1983 to 1986, Mr. Konrath was the President and Chief Executive Officer of Security Pacific Housing Services, where he founded a new subsidiary focused on manufactured housing loans. Mr. Konrath earned his Bachelor of Arts degree in Accounting with a minor in Economics from the University of Wisconsin Whitewater in 1969.

Joseph J. Lydon, 47, has served as our President and Chief Operating Officer since the REIT s formation in May 2004. Mr. Lydon has also served as Accredited s President and Chief Operating Officer since May 1998 and as a director since July 2004. From February 1997 until that time, Mr. Lydon was Accredited s Director of Sales and Marketing. From 1993 to 1997, Mr. Lydon was the Executive Vice President for the western division of Ford Consumer Finance, a division of The Associates First Capital Corporation. From 1977 to 1993, Mr. Lydon worked at Security Pacific Financial Services, Inc. where he ultimately became a Senior Vice President with full profit and loss responsibilities and oversight of six divisions. Mr. Lydon earned his Bachelor of Science degree in Management from Pepperdine University in 1991.

Stuart D. Marvin, 46, has served as our Executive Vice President since April 2005. Mr. Marvin oversees finance, capital markets and corporate communications. He has over 22 years of experience in the financial services and non-prime mortgage industry. Prior to joining Accredited, he was President, Corporate Operations and Chief Financial Officer for Aegis Mortgage Corporation and a partner at PriceWaterhouse Coopers, LLP focusing on mortgage banking and financial institutions. Mr. Marvin is a Certified Public Accountant and earned a Bachelor of Science degree with honors in accounting from Jacksonville (FL) University in 1982.

John S. Buchanan, 50, has served as our Chief Financial Officer since the REIT s formation in May 2004. Mr. Buchanan has also served as Accredited s Chief Financial Officer since April 2001. Prior to joining Accredited, Mr. Buchanan was Controller of GreenPoint Credit, a non-prime consumer finance entity, from 1998 to 2001. There, Mr. Buchanan was responsible for accounting, planning, financial analysis, cash management and facilities. From 1992 to 1998, Mr. Buchanan was Senior Vice President and Chief Financial Officer of GreenPoint Credit s predecessor, BankAmerica Housing Services. From 1981 to 1990, Mr. Buchanan worked for Security Pacific Financial Services, Inc. where he ultimately became Vice President of Financial Planning and Analysis. Mr. Buchanan earned his Bachelor of Science degree in Business in 1978 from San Diego State University.

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David E. Hertzel, 51, has served as our General Counsel since the REIT s formation in May 2004. Mr. Hertzel has also served as Accredited s General Counsel since December 1995. Mr. Hertzel is responsible for regulatory compliance, licensing and qualification, corporate record-keeping, litigation, contract negotiation and all other legal matters. Prior to joining Accredited, Mr. Hertzel was Vice President and Senior Counsel of American Residential Mortgage Corporation, from 1991 to 1994. From 1988 to 1991, he was Vice President and Senior Counsel of Imperial Savings Association. Mr. Hertzel earned his Juris Doctor degree from the University of Utah College of Law in 1980 and is a member of the State Bar of California.

Each of these individuals is also an executive officer of Accredited.

Executive Offices

Our principal executive offices are located at 15090 Avenue of Science, San Diego, California 92128 (telephone number (858) 676-2100).

Access to SEC Filings

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

Although we do not maintain our own website, our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished by us pursuant to the Securities Exchange Act of 1934 will be accessible at no cost on Accredited s website, http://www.accredhome.com, as soon as reasonably practicable after those reports have been electronically filed or submitted to the SEC. These filings will also be accessible on the SEC s website, http://www.sec.gov.

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ITEM 1A. Risk Factors

Risk Factors and Accredited s Guarantee of Our Series A Preferred Shares

You should carefully consider the following risks, together with other matters described in this Form 10-K in evaluating our business and prospects. If any of the events referred to actually occur, our business, financial condition, liquidity and results of operations could suffer. The risks described are not the only ones we face. Additional risks not presently known to us or that we currently deem immaterial may also impair our business operations. Certain statements in this Form 10-K (including certain of the following risk factors) constitute forward-looking statements. Please refer to the section entitled Forward-Looking Statements on page 6 of this Form 10-K.

Risks Related to REIT s Business

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

We use various derivative financial instruments to provide a level of protection against interest rate risks, but no hedging strategy can protect us completely. When rates change, we expect to record a gain or loss on derivatives, which would be offset by an inverse change in the value of our securitized loans subject to portfolio based accounting, as reflected in the Interest Rate Simulation Sensitivity Analysis in the section entitled Market Risk in ITEM 7. Management s Discussion and Analysis of Financial Condition and Results of Operations. We cannot assure you, however, that our use of derivatives will offset the risks related to changes in interest rates. There have been periods, and it is likely that there will be periods in the future, during which we will not have offsetting gains or losses in loan values after accounting for our derivative financial instruments. The derivative financial instruments we select may not have the effect of reducing our interest rate risk. In addition, the nature and timing of hedging transactions may influence the effectiveness of these strategies. Poorly designed strategies, improperly executed transactions, or inaccurate assumptions could actually increase our risk and losses. In addition, hedging strategies involve transaction and other costs. We cannot assure you that our hedging strategy and the derivatives that we use will adequately offset the risk of interest rate volatility or that our hedging transactions will not result in losses. See discussion under Market Risk under ITEM 7. Management s Discussion and Analysis of Financial Condition and Results of Operations.

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

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

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

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

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

Our securitized mortgage loans have certain geographic concentrations in a number of states, which may present a greater risk of loss if conditions in those states become adverse. In these states, if the residential real estate market should experience an overall decline in property values after the dates of origination of the mortgage loans, the rates of delinquencies, foreclosures, bankruptcies and losses on the mortgage loans may increase over historical levels of comparable type loans, and may increase substantially. In addition, properties located in California and Florida may be more susceptible than homes located in other parts of the country to certain types of uninsured hazards, such as earthquakes, wildfires, hurricanes, floods, mudslides and other natural disasters. As of December 31, 2005, 23% and 11% of the unpaid principal amounts of the mortgage loans in our portfolio were secured by properties located in California and Florida, respectively.

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

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

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

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

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

We may in the future become a defendant in lawsuits which seek to recover substantial amounts from us. No assurances can be given that we will be able to successfully defend all or any of such lawsuits, and adverse results in one or more of such lawsuits could have a material adverse effect on us. In addition, we could be adversely affected by litigation to which Accredited is a party.

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

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

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

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

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

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

The early termination of an underlying securitization trust could substantially reduce or even elim