

HFF, Inc.  
Form 10-Q  
November 10, 2008

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D. C. 20549  
FORM 10-Q**

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

**For the quarterly period ended September 30, 2008**

**OR**

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

**For the transition period from**

**to**

**Commission file number: 001-33280**

**HFF, Inc.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State of Incorporation)

**51-0610340**

(I.R.S. Employer Identification No.)

**One Oxford Centre  
301 Grant Street, Suite 600  
Pittsburgh, Pennsylvania**

(Address of principal executive offices)

**15219**

(Zip code)

(412) 281-8714

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Sections 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 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. (Check one):

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 Exchange Act). Yes  No

Number of shares of Class A common stock, par value \$0.01 per share, and of Class B common stock, par value \$0.01 per share, of the registrant outstanding as of October 31, 2008 was 16,446,480 shares and 1 share, respectively.

**HFF, INC. AND SUBSIDIARIES**  
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**FORWARD-LOOKING STATEMENTS**

This Quarterly Report on Form 10-Q contains forward-looking statements, which reflect our current views with respect to, among other things, our operations and financial performance. You can identify these forward-looking statements by the use of words such as outlook, believes, expects, potential, continues, may, will, should, approximately, predicts, intends, plans, estimates, anticipates or the negative version of these words or other comparable words. Such forward-looking statements are subject to various risks and uncertainties. Accordingly, there are or will be important factors that could cause actual outcomes or results to differ materially from those indicated in these statements. We believe these factors include, but are not limited to, those described under Risk Factors. These factors should not be construed as exhaustive and should be read in conjunction with the other cautionary statements that are included in this Quarterly Report on Form 10-Q. We undertake no obligation to publicly update or review any forward-looking statement, whether as a result of new information, future developments or otherwise.

**SPECIAL NOTE REGARDING THE REGISTRANT**

In connection with our initial public offering of our Class A common stock in February 2007, we effected a reorganization of our business, which had previously been conducted through HFF Holdings LLC ( HFF Holdings ) and certain of its wholly-owned subsidiaries, including Holliday Fenoglio Fowler, L.P. and HFF Securities L.P. (together, the Operating Partnerships ) and Holliday GP Corp. ( Holliday GP ). In the reorganization, HFF, Inc., a newly-formed Delaware corporation, purchased from HFF Holdings all of the shares of Holliday GP, which is the sole general partner of each of the Operating Partnerships, and approximately 45% of the partnership units in each of the Operating Partnerships (including partnership units in the Operating Partnerships held by Holliday GP) in exchange for the net proceeds from the initial public offering and one share of Class B common stock of HFF, Inc. Following this reorganization and as of the closing of the initial public offering on February 5, 2007, HFF, Inc. is a holding company holding partnership units in the Operating Partnerships and all of the outstanding shares of Holliday GP. HFF Holdings and HFF, Inc., through their wholly-owned subsidiaries, are the only limited partners of the Operating Partnerships. We refer to these transactions collectively in this Quarterly Report on Form 10-Q as the Reorganization Transactions. Unless we state otherwise, the information in this Quarterly Report on Form 10-Q gives effect to these Reorganization Transactions.

Unless the context otherwise requires, references to (1) HFF Holdings refer solely to HFF Holdings LLC, a Delaware limited liability company that was previously the holding company for our consolidated subsidiaries, and not to any of its subsidiaries, (2) HFF LP refer to Holliday Fenoglio Fowler, L.P., a Texas limited partnership, (3) HFF Securities refer to HFF Securities L.P., a Delaware limited partnership and registered broker-dealer, (4) Holliday GP refer to Holliday GP Corp., a Delaware corporation and the general partner of HFF LP and HFF Securities, (5) HoldCo LLC refer to HFF Partnership Holdings LLC, a Delaware limited liability company and a wholly-owned subsidiary of HFF, Inc. and (6) Holdings Sub refer to HFF LP Acquisition LLC, a Delaware limited liability company and wholly-owned subsidiary of HFF Holdings. Our business operations are conducted by HFF LP and HFF Securities which are sometimes referred to in this Quarterly Report on Form 10-Q as the Operating Partnerships. Also, except where specifically noted, references in this Quarterly Report on Form 10-Q to the Company, we or us mean HFF, Inc., the newly-formed Delaware corporation and its consolidated subsidiaries after giving effect to the Reorganization Transactions.

**Table of Contents****PART 1. FINANCIAL INFORMATION****Item 1. Financial Statements**

HFF, Inc.  
 Consolidated Balance Sheets  
*(Dollars in Thousands)*

	<b>September 30, 2008</b> <i>(unaudited)</i>	<b>December 31, 2007</b> <i>(audited)</i>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 26,740	\$ 43,739
Restricted cash <i>(Note 8)</i>	221	370
Investments <i>(Note 4)</i>	9,998	
Accounts receivable, net of allowance for doubtful accounts of \$40 and \$0, respectively	1,124	1,496
Receivable from affiliate <i>(Note 19)</i>	1,264	1,210
Mortgage notes receivable <i>(Note 9)</i>	100,256	41,000
Prepaid expenses and other current assets	8,646	4,036
Deferred tax assets, net	96	344
Total current assets, net	148,345	92,195
Property and equipment, net <i>(Note 5)</i>	5,631	6,789
Deferred tax assets	124,129	131,408
Goodwill	3,712	3,712
Intangible assets, net <i>(Note 6)</i>	7,198	5,769
Other noncurrent assets	514	603
<b>Total Assets</b>	<b>\$289,529</b>	<b>\$240,476</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Current portion of long-term debt <i>(Note 8)</i>	\$ 92	\$ 78
Warehouse line of credit <i>(Note 9)</i>	100,256	41,000
Accrued compensation and related taxes	8,356	12,952
Accounts payable	850	1,946
Other current liabilities	2,548	2,481
Total current liabilities	112,102	58,457
Deferred rent credit	3,920	4,600
Payable under the tax receivable agreement <i>(Note 14)</i>	108,287	117,406
Other long-term liabilities	98	74
Long-term debt, less current portion <i>(Note 8)</i>	73	111
Total liabilities	224,480	180,648
Minority interest <i>(Note 16)</i>	25,871	21,784
Stockholders equity:		

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Class A common stock, par value \$0.01 per share, 175,000,000 authorized, and 16,446,480 and 16,445,000 shares outstanding, respectively	<b>164</b>	164
Class B common stock, par value \$0.01 per share, 1 share authorized, and 1 share outstanding		
Additional paid-in-capital	<b>26,036</b>	25,353
Accumulated other comprehensive income, net of tax	<b>21</b>	
Retained earnings	<b>12,957</b>	12,527
Total stockholders' equity	<b>39,178</b>	38,044
Total liabilities and stockholders' equity	<b>\$289,529</b>	\$240,476

*See accompanying notes to the consolidated financial statements.*

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HFF, Inc.  
 Consolidated Statements of Income  
*(Dollars in Thousands, except per share data)*

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
<b>Revenues</b>				
Capital markets services revenue	<b>\$29,441</b>	\$66,463	<b>\$103,003</b>	\$199,565
Interest on mortgage notes receivable	<b>698</b>	246	<b>1,421</b>	1,081
Other	<b>895</b>	1,320	<b>2,379</b>	2,714
	<b>31,034</b>	68,029	<b>106,803</b>	203,360
<b>Expenses</b>				
Cost of services	<b>20,014</b>	39,166	<b>69,365</b>	116,854
Personnel	<b>2,160</b>	4,605	<b>7,018</b>	14,307
Occupancy	<b>1,930</b>	2,134	<b>5,689</b>	6,012
Travel and entertainment	<b>970</b>	991	<b>4,855</b>	4,635
Supplies, research, and printing	<b>1,523</b>	2,655	<b>5,841</b>	6,703
Insurance	<b>490</b>	518	<b>1,537</b>	1,420
Professional fees	<b>1,162</b>	1,370	<b>3,306</b>	4,235
Depreciation and amortization	<b>1,111</b>	993	<b>2,587</b>	2,891
Interest on warehouse line of credit	<b>602</b>	263	<b>1,167</b>	1,169
Other operating	<b>1,170</b>	1,734	<b>3,648</b>	4,441
	<b>31,132</b>	54,429	<b>105,013</b>	162,667
Operating (loss) / income	<b>(98)</b>	13,600	<b>1,790</b>	40,693
Interest and other income, net	<b>1,849</b>	2,170	<b>3,775</b>	4,086
Interest expense	<b>(4)</b>	(4)	<b>(15)</b>	(404)
Decrease in payable under the tax receivable agreement	<b>282</b>		<b>3,862</b>	
Income before income taxes and minority interest	<b>2,029</b>	15,766	<b>9,412</b>	44,375
Income tax expense	<b>369</b>	2,947	<b>4,833</b>	7,839
Income before minority interest	<b>1,660</b>	12,819	<b>4,579</b>	36,536
Minority interest	<b>1,335</b>	8,808	<b>4,149</b>	24,229
Net income	<b>\$ 325</b>	\$ 4,011	<b>\$ 430</b>	\$ 12,307
Less net income earned prior to IPO and reorganization ( <i>Note 15</i> )				(1,893)

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Net income attributable to Class A common stockholders	\$ 325	\$ 4,011	\$ 430	\$ 10,414
Earnings per share of Class A common stock:				
Basic	\$ 0.02	\$ 0.24	\$ 0.03	\$ 0.72
Diluted	\$ 0.02	\$ 0.24	\$ 0.03	\$ 0.72

*See accompanying notes to the consolidated financial statements.*

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HFF, Inc.  
 Consolidated Statements of Cash Flows  
*(Dollars In Thousands)*

	<b>Nine Months Ended September</b>	
	<b>30</b>	
	<b>2008</b>	<b>2007</b>
<b>Operating activities</b>		
Net income	\$ 430	\$ 12,307
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Minority interest	4,149	24,229
Stock based compensation	706	646
Amortization of investment security discounts	(67)	
Deferred taxes	7,506	4,720
Provision for bad debts	40	
Payable under the tax receivable agreement	(3,862)	
Depreciation and amortization:		
Property and equipment	1,217	1,874
Intangibles	1,370	1,017
Gain on sale or disposition of assets, net	(1,558)	(405)
Mortgage service rights assumed	(1,138)	(2,045)
Increase (decrease) in cash from changes in:		
Restricted cash	149	1,956
Accounts receivable	332	1,463
Receivable from /payable to affiliates	(54)	2,411
Payable under the tax receivable agreement	(5,257)	
Deferred taxes, net	(5)	
Mortgage notes receivable	(59,256)	57,950
Net borrowings on warehouse line of credit	59,256	(57,950)
Prepaid expenses and other current assets	(4,610)	1,575
Other noncurrent assets	89	94
Accrued compensation and related taxes	(4,596)	16,589
Accounts payable	(1,096)	341
Other accrued liabilities	67	(1,032)
Other long-term liabilities	(516)	2,257
Net cash (used in) provided by operating activities	(6,704)	67,997
<b>Investing activities</b>		
Purchases of property and equipment	(161)	(4,273)
Non-compete agreement	(100)	
Purchase of investments	(9,907)	
Net cash used in investing activities	(10,168)	(4,273)
<b>Financing activities</b>		
Payments on long-term debt	(65)	(56,350)

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Issuance of common stock, net		272,118
Purchase of ownership interests in Operating Partnerships and Holliday GP		(215,931)
Deferred financing costs		(276)
Distributions to members and minority interest holder	(62)	(7,070)
Net cash used in financing activities	(127)	(7,509)
Net (decrease) increase in cash	(16,999)	56,215
Cash and cash equivalents, beginning of period	43,739	3,345
Cash and cash equivalents, end of period	\$ 26,740	\$ 59,560

*See accompanying notes to the consolidated financial statements.*

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## HFF, Inc.

## Notes to Consolidated Financial Statements

**1. Organization and Basis of Presentation****Organization**

HFF, Inc., through its Operating Partnerships, Holliday Fenoglio Fowler, L.P., a Texas limited partnership ( HFF LP ), and HFF Securities L.P., a Delaware limited partnership and registered broker-dealer ( HFF Securities ) and together with HFF LP, the Operating Partnerships ), is a financial intermediary and provides capital markets services including debt placement, investment sales, structured finance, private equity, investment banking and advisory services, note sales and note sale advisory services and commercial loan servicing and commercial real estate structured financing placements mainly in the United States through its 18 offices in the United States.

HFF LP was acquired on June 16, 2003 and accounted for in accordance with Statement of Financial Accounting Standards (SFAS) No. 141, *Business Combinations* (SFAS No. 141). The total purchase price of \$8.8 million was allocated to the assets acquired and liabilities assumed based on estimated fair values at the date of acquisition.

During 2004, HFF LP and Holliday GP Corp., a Delaware corporation ( Holliday GP ), formed HFF Securities. HFF Securities is a broker-dealer that performs private placements of securities by raising equity capital from institutional investors for discretionary, commingled real estate funds to execute real estate acquisitions, recapitalizations, developments, debt investments, and other real estate-related strategies. HFF Securities may also provide other investment banking and advisory services on various project or entity-level strategic assignments such as mergers and acquisitions, sales and divestitures, recapitalizations and restructurings, privatizations, management buyouts, and arranging joint ventures for specific real estate strategies.

**Offering and Reorganization**

HFF, Inc., a Delaware corporation, was formed in November 2006 in connection with a proposed initial public offering of its Class A common stock. On November 9, 2006, HFF, Inc. filed a registration statement on Form S-1 with the United States Securities and Exchange Commission (the SEC ) relating to a proposed underwritten initial public offering of 14,300,000 shares of Class A common stock of HFF, Inc. ( the Offering ). On January 30, 2007, the SEC declared the registration statement on Form S-1 effective and HFF, Inc. priced 14,300,000 shares for the initial public offering at a price of \$18.00 per share. On January 31, 2007, HFF, Inc.'s common stock began trading on the New York Stock Exchange under the symbol HF.

The proceeds of the public offering were used to purchase from HFF Holdings all of the shares of Holliday GP and purchase from HFF Holdings partnership units representing approximately 39% of each of the Operating Partnerships (including partnership units in the Operating Partnerships held by Holliday GP).

On February 21, 2007, the underwriters exercised their option to purchase an additional 2,145,000 shares of Class A common stock (15% of original issuance) at \$18.00 per share. These proceeds were used to purchase HFF Holdings partnership units representing approximately 6.0% of each of the Operating Partnerships. The Company did not retain any of the proceeds from the Offering.

In addition to cash received for its sale of all of the shares of Holliday GP and approximately 45% of partnership units of each of the Operating Partnerships (including partnership units in the Operating Partnerships held by Holliday GP), HFF Holdings also received an exchange right that will permit HFF Holdings to exchange interests in the Operating Partnerships for shares of (i) HFF, Inc.'s Class A common stock (the Exchange Right ) and (ii) rights under a tax receivable agreement between HFF, Inc. and HFF Holdings (the TRA ). See Notes 17 and 14 for further discussion of the exchange right held by the majority interest holder and the tax receivable agreement, respectively.

As a result of the reorganization, HFF, Inc. became a holding company through a series of transactions pursuant to a sale and purchase agreement. Pursuant to the Offering and reorganization, HFF, Inc.'s sole assets are through its wholly-owned subsidiary HFF Partnership Holdings, LLC, a Delaware limited liability company ( Partnership Holdings ), partnership interests in HFF LP and HFF Securities and all of the shares of Holliday GP. The transactions that occurred in connection with the initial public offering and reorganization are referred to as the Reorganization Transactions.

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The Reorganization Transactions are being treated, for financial reporting purposes, as a reorganization of entities under common control. As such, these financial statements present the consolidated financial position and results of operations as if HFF, Inc., Holliday GP and the Operating Partnerships (collectively referred to as the Company ) were consolidated for all periods presented. All income earned by the Operating Partnerships prior to the offering is attributable to members of HFF Holdings. Income earned by the Operating Partnerships subsequent to the offering and attributable to the members of HFF Holdings is recorded as minority interest in the consolidated financial statements, with remaining income less applicable income taxes attributable to Class A common stockholders.

**Basis of Presentation**

The accompanying consolidated financial statements of HFF, Inc. as of September 30, 2008 and December 31, 2007 and for the three and nine month periods ended September 30, 2008 and September 30, 2007, include the accounts of HFF LP, HFF Securities, and HFF, Inc.'s wholly-owned subsidiaries, Holliday GP and Partnership Holdings. All significant intercompany accounts and transactions have been eliminated.

The purchase of shares of Holliday GP and partnership units in each of the Operating Partnerships are treated as reorganization under common control for financial reporting purposes. HFF Holdings owned 100% of Holliday GP, HFF LP Acquisition, LLC, a Delaware limited liability company ( Holdings Sub ), and the Operating Partnerships prior to the Reorganization Transactions and continues to control these entities through HFF, Inc. The initial purchase of shares of Holliday GP and the initial purchase of units in the Operating Partnerships were accounted for at historical cost, with no change in basis for financial reporting purposes. Accordingly, the net assets of HFF Holdings purchased by HFF, Inc. are reported in the consolidated financial statements of HFF, Inc. at HFF Holdings' historical cost.

As the sole stockholder of Holliday GP, the sole general partner of the Operating Partnerships, HFF, Inc. now operates and controls all of the business and affairs of the Operating Partnerships. HFF, Inc. consolidates the financial results of the Operating Partnerships, and the ownership interest of HFF Holdings in the Operating Partnerships is treated as a minority interest in HFF, Inc.'s consolidated financial statements. HFF Holdings, through its wholly-owned subsidiary, Holdings Sub, and HFF, Inc., through its wholly-owned subsidiaries Partnership Holdings and Holliday GP, are the only partners of the Operating Partnerships following the offering.

Income earned by the Operating Partnerships subsequent to the offering and attributable to the members of HFF Holdings based on their remaining ownership interest (see Notes 15 and 16) is recorded as minority interest in the consolidated financial statements, with remaining income less applicable income taxes attributable to Class A common stockholders, and considered in the determination of earnings per share of Class A common stock (see Note 18).

**Reclassifications**

Certain items in the consolidated financial statements of prior years have been reclassified to conform to the current year's presentation.

**2. Summary of Significant Accounting Policies**

These interim financial statements have been prepared in accordance with accounting principles generally accepted in the United States ( GAAP ) for interim financial information, the instructions to Quarterly Report on Form 10-Q and Rule 10-01 of Regulation S-X and should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2007. Accordingly, significant accounting policies and disclosures normally provided have been omitted as such items are disclosed therein. In the opinion of management, all adjustments consisting of normal and recurring entries considered necessary for a fair presentation of the results for the interim periods presented have been included. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect reported amounts in the financial statements and accompanying notes. These estimates are based on information available as of the date of the unaudited consolidated financial statements. Therefore, actual results could differ from those estimates. Furthermore, operating results for the three and nine months ended September 30, 2008 are not necessarily indicative of the results expected for the year ending December 31, 2008.

**Table of Contents****Consolidation**

HFF, Inc. controls the activities of the operating partnerships through its 100% ownership interest of Holliday GP. As such, in accordance with FASB Interpretation 46(R), *Consolidation of Variable Interest Entities (revised December 2003)* an interpretation of ARB No. 51 (Issued 12/03) and Emerging Issues Task Force Abstract 04-5, *Determining Whether a General Partner, or General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights*, Holliday GP consolidates the Operating Partnerships as Holliday GP is the sole general partner of the Operating Partnerships and the limited partners do not have substantive participating rights or kick out rights. The ownership interest of HFF Holdings in the Operating Partnerships is reflected as a minority interest in HFF, Inc.'s consolidated financial statements.

The accompanying consolidated financial statements of HFF, Inc. as of September 30, 2008 and December 31, 2007, and for the three and nine month periods ended September 30, 2008 and September 30, 2007, include the accounts of HFF LP, HFF Securities, and HFF, Inc.'s wholly-owned subsidiaries, Holliday GP and Partnership Holdings. The ownership interest of HFF Holdings in HFF LP and HFF Securities is treated as a minority interest in the consolidated financial statements of HFF, Inc. All significant intercompany accounts and transactions have been eliminated.

**Income Taxes**

HFF, Inc. and Holliday GP are corporations, and the Operating Partnerships are limited partnerships. The Operating Partnerships are subject to state and local income taxes. Income and expenses of the Operating Partnerships have been passed through and are reported on the individual tax returns of the members of HFF Holdings and on the corporate income tax returns of HFF, Inc. and Holliday GP. Income taxes shown on the Company's Consolidated Statements of Income reflect federal income taxes of the corporation and business and corporate income taxes in various jurisdictions. These taxes are assessed on the net income of the corporation, including its share of the Operating Partnerships' net income.

The Company accounts for income taxes under the asset and liability method. Deferred tax assets and liabilities are recognized for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, and for tax losses and tax credit carryforwards, if any. Deferred tax assets and liabilities are measured using tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates are recognized in income in the period of the tax rate change. In assessing the realizability of deferred tax assets, the Company considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized.

**Earnings Per Share**

Subsequent to the Reorganization Transactions, the Company computes net income per share in accordance with SFAS No. 128, *Earnings Per Share*. Basic net income per share is computed by dividing income available to Class A common stockholders by the weighted average of Class A common shares outstanding for the period. Diluted net income per share reflects the assumed conversion of all dilutive securities (see Note 18). Prior to the Reorganization Transactions, the Company historically operated as a series of related partnerships and limited liability companies. There was no single capital structure upon which to calculate historical earnings per share information. Accordingly, earnings per share information has not been presented for periods prior to the initial public offering.

**Intangible Assets**

Intangible assets include mortgage servicing rights under agreements with third-party lenders, costs associated with obtaining a FINRA license, a non-compete agreement, and deferred financing costs.

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Servicing rights are capitalized for servicing assumed on loans originated and sold to the Federal Home Loan Mortgage Corporation (Freddie Mac) and mortgage servicing rights acquired without the exchange of initial consideration with servicing retained based on an allocation of the carrying amount of the loan and the servicing right in proportion to the relative fair values at the date of sale. Servicing rights are recorded at the lower of cost or market. Mortgage servicing rights do not trade in an active, open market with readily available observable prices. Since there is no ready market value for the mortgage servicing rights, such as quoted market prices or prices based on sales or purchases of similar assets, the Company determines the fair value of the mortgage servicing rights by estimating the present value of future cash flows associated with servicing the loans. Management makes certain assumptions and judgments in estimating the fair value of servicing rights. The estimate is based on a number of assumptions, including the benefits of servicing (contractual servicing fees and interest on escrow and float balances), the cost of servicing, prepayment rates (including risk of default), an inflation rate, the expected life of the cash flows and the discount rate. The cost of servicing and discount rate are the most sensitive factors affecting the estimated fair value of the servicing rights. Management estimates a market participant's cost of servicing by analyzing the limited market activity and considering the Company's own internal servicing costs. Management estimates the discount rate by considering the various risks involved in the future cash flows of the underlying loans which include the cancellation of servicing contracts, concentration in the life company portfolio and the incremental risk related to large loans. Management estimates the prepayment levels of the underlying mortgages by analyzing recent historical experience. Many of the commercial loans being serviced have financial penalties for prepayment or early payoff before the stated maturity date. As a result, the Company has consistently experienced a low level of loan runoff. The estimated value of the servicing rights is impacted by changes in these assumptions.

Effective January 1, 2007, the Company adopted the provisions of the Statement of Financial Accounting Standards Board (SFAS) No. 156, *Accounting for Servicing of Financial Assets – an amendment of FASB Statement No. 140*, or SFAS 156. Under SFAS 156, the standard requires an entity to recognize a servicing asset or servicing liability at fair value each time it undertakes an obligation to service a financial asset by entering into a servicing contract, regardless of whether explicit consideration is exchanged. The statement also permits a company to choose to either subsequently measure servicing rights at fair value and to report changes in fair value in earnings, or to retain the amortization method whereby servicing rights are recorded at the lower of cost or fair value and are amortized over their expected life. The Company retained the amortization method upon adoption of SFAS 156, but began recognizing the fair value of servicing contracts involving no consideration assumed after January 1, 2007, which resulted in the Company recording \$0.5 million and \$1.1 million of intangible assets and a corresponding amount to income upon initial recognition of the servicing rights for the three and nine month periods ended September 30, 2008, respectively. The Company recorded \$1.1 million and \$2.0 million of intangible assets and a corresponding amount to income upon initial recognition of the servicing rights for the three and nine month periods ended September 30, 2007, respectively. These amounts are recorded in Interest and other income, net in the Consolidated Statements of Income.

Deferred financing costs are deferred and are being amortized by the straight-line method over four years, which approximates the effective interest method.

HFF Securities has recognized an intangible asset in the amount of \$0.1 million for the costs of obtaining a FINRA license as a broker-dealer. The license is determined to have an indefinite useful economic life and is, therefore, not being amortized.

The Company evaluates amortizable intangible assets on an annual basis, or more frequently if circumstances so indicate, for potential impairment. Indicators of impairment monitored by management include a decline in the level of serviced loans.

**Stock Based Compensation**

Effective January 1, 2006, the Company adopted SFAS No. 123(R) using the modified prospective method. Under this method, the Company recognizes compensation costs based on grant-date fair value for all share-based awards granted, modified or settled after January 1, 2006, as well as for any awards that were granted prior to the adoption for which requisite service has not been provided as of January 1, 2006. The Company did not grant any share-based awards prior to January 31, 2007. SFAS No. 123(R) requires the measurement and recognition of compensation

expense for all stock-based payment awards made to employees and directors including employee stock options and other forms of equity compensation based on estimated fair values. The Company estimates the grant-date fair value of stock options using the Black-Scholes option-pricing model. For restricted stock awards, the fair value of the awards is calculated as the difference between the market value of the Company's Class A common stock on the

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date of grant and the purchase price paid by the employee. The Company's awards are generally subject to graded vesting schedules. Compensation expense is adjusted for estimated forfeitures and is recognized on a straight-line basis over the requisite service period of the award. Forfeiture assumptions are evaluated on a quarterly basis and updated as necessary.

**Investments**

The Company's available-for-sale securities include United States Treasury Bills. These investments are carried at fair value based on quoted market prices in active markets for identical instruments. If quoted market prices are not available, fair value is based upon quoted prices for similar instruments in active markets. These investments may be classified as current or long-term assets and are included in Investments or Other noncurrent assets, respectively, on the Consolidated Balance Sheets based on management's ability or intention to sell the investment. The amortization of the discount is recognized as income based on the effective interest method and is recorded in Interest and other income, net in the Consolidated Statements of Income. The unrealized gains or losses on securities available-for-sale are recorded net of tax in Accumulated other comprehensive income, net of tax on the Consolidated Balance Sheets. Realized gains or losses on these securities are computed on a specific-identification basis and recognized in Interest and other income, net in the Consolidated Statements of Income.

On a periodic basis, management evaluates the carrying value of investments for impairment. With respect to the investments in United States Treasury Bills, management considers various criteria, including the duration and extent of a decline in fair value and the ability and intent of management to retain the investment for a period of time sufficient to allow the value to recover to determine whether a decline in fair value is other than temporary. If, after considering these criteria, management believes that a decline is other than temporary, the carrying value of the security is written down to fair value and recognized in Interest and other income, net in the Consolidated Statements of Income.

**Comprehensive Income**

The Company reports all changes in comprehensive income in the Consolidated Statements of Stockholders' Equity, in accordance with the provisions of SFAS No. 130, *Reporting Comprehensive Income*. Comprehensive income includes net income and unrealized gains and losses on securities available for sale, net of tax.

Comprehensive income was \$0.4 million and \$0.5 million for the three and nine month periods ended September 30, 2008, respectively, and \$4.0 million and \$10.4 million, respectively, for the same periods of 2007.

**Recent Accounting Pronouncements**

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51*. SFAS No. 160 will change the accounting and reporting for minority interests, which will be recharacterized as noncontrolling interests and classified as a component of equity. This new consolidation method will significantly change the accounting for transactions with minority interest holders. The provisions of this standard are effective beginning January 1, 2009. Prior to adoption, the Company will evaluate the impact on its consolidated financial position and results of operations.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities - Including an amendment of FASB Statement No. 115*. This new standard is designed to reduce complexity in accounting for financial instruments and lessen earnings volatility caused by measuring related assets and liabilities differently. The standard creates presentation and disclosure requirements designed to aid comparisons between companies that use different measurement attributes for similar types of assets and liabilities. The standard, which is expected to expand the use of fair value measurement, permits entities to choose to measure many financial instruments and certain other items at fair value, with unrealized gains and losses on those assets and liabilities recorded in earnings. The fair value option may be applied on a financial instrument by financial instrument basis, with a few exceptions, and is irrevocable for those financial instruments once applied. The fair value option may only be applied to entire financial instruments, not portions of instruments. The standard does not eliminate disclosures required by SFAS No. 107, *Disclosures About Fair Value of Financial Instruments*, or SFAS No. 157, *Fair Value Measurements*, the latter of which is described below. The provisions of the standard were effective for consolidated financial statements beginning January 1, 2008. The Company did not elect the fair value option upon adoption of SFAS 159 on January 1, 2008.





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In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157). This new standard defines fair value, establishes a framework for measuring fair value in conformity with GAAP, and expands disclosures about fair value measurements. Prior to this standard, there were varying definitions of fair value, and the limited guidance for applying those definitions under GAAP was dispersed among the many accounting pronouncements that require fair value measurements. The new standard defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The standard applies under other accounting pronouncements that require or permit fair value measurements, since the FASB previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. As a result, the new standard does not establish any new fair value measurements itself, but applies to other accounting standards that require the use of fair value for recognition or disclosure. In particular, the framework in the new standard will be required for financial instruments for which fair value is elected.

The new standard requires companies to disclose the fair value of its financial instruments according to a fair value hierarchy. The fair value hierarchy ranks the quality and reliability of the information used to determine fair values. Financial instruments carried at fair value will be classified and disclosed in one of the three categories in accordance with the hierarchy. The three levels of the fair value hierarchy are:

*level 1:* Quoted market prices for identical assets or liabilities in active markets;

*level 2:* Observable market-based inputs or unobservable inputs corroborated by market data; and

*level 3:* Unobservable inputs that are not corroborated by market data.

In addition, the standard requires enhanced disclosure with respect to the activities of those financial instruments classified within the level 3 category, including a roll-forward analysis of fair value balance sheet amounts for each major category of assets and liabilities and disclosure of the unrealized gains and losses for level 3 positions held at the reporting date.

The standard is intended to increase consistency and comparability in fair value measurements and disclosures about fair value measurements, and encourages entities to combine the fair value information disclosed under the standard with the fair value information disclosed under other accounting pronouncements, including SFAS No. 107, *Disclosures about Fair Value of Financial Instruments*, where practicable. The provisions of this standard were effective beginning January 1, 2008. Our adoption of the standard's provisions did not materially impact our consolidated financial position and results of operations.

In February 2008, the FASB issued FSP FAS No. 157-2 *Effective Date of FASB Statement No. 157* (FSP FAS 157-2) which delays the effective date of SFAS 157 to fiscal years beginning after November 15, 2008 for certain nonfinancial assets and liabilities including, but not limited to, nonfinancial assets and liabilities initially measured at fair value in a business combination that are not subsequently remeasured at fair value and nonfinancial assets and liabilities measured at fair value in the SFAS 142 goodwill impairment test. As a result of the issuance of FSP FAS 157-2, the Company did not apply the provisions of SFAS 157 to the nonfinancial assets and liabilities within the scope of FSP FAS 157-2.

On October 10, 2008, the FASB issued FSP FAS No. 157-3 *Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active* (FSP FAS 157-3), which clarifies the application of SFAS 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. The adoption of FSP FAS 157-3 had no impact on our consolidated financial position and results of operations.

**Table of Contents****3. Stock Compensation**

Effective January 1, 2006, the Company adopted SFAS No. 123(R) using the modified prospective method. Under this method, the Company recognizes compensation costs based on grant-date fair value for all share-based awards granted, modified or settled after January 1, 2006, as well as for any awards that were granted prior to the adoption for which requisite service has not been provided as of January 1, 2006. The Company did not grant any share-based awards prior to January 31, 2007. SFAS No. 123(R) requires the measurement and recognition of compensation expense for all stock-based payment awards made to employees and directors including employee stock options and other forms of equity compensation based on estimated fair values. The Company estimates the grant-date fair value of stock options using the Black-Scholes option-pricing model. For restricted stock awards, the fair value of the awards is calculated as the difference between the market value of the Company's Class A common stock on the date of grant and the purchase price paid by the employee. The Company's awards are generally subject to graded vesting schedules. Compensation expense is adjusted for estimated forfeitures and is recognized on a straight-line basis over the requisite service period of the award. Forfeiture assumptions are evaluated on a quarterly basis and updated as necessary. During the three month period ending September 30, 2008, no vested restricted stock units were converted to Class A common stock and 38,100 new restricted stock units were granted. During the three month period ending September 30, 2008, no new stock options were granted.

The stock compensation cost that has been charged against income for the three and nine months ended September 30, 2008 was \$0.4 million and \$0.7 million, respectively, which is recorded in Personnel expenses in the Consolidated Statements of Income. The stock compensation cost that has been charged against income for the three and nine month periods ended September 30, 2007 was \$0.2 million and \$0.6 million, respectively. At September 30, 2008, there was approximately \$1.6 million of unrecognized compensation cost related to share based awards.

No options were vested or were exercised during the three months ended September 30, 2008.

The fair value of vested restricted stock units was \$0.2 million at September 30, 2008.

The weighted average remaining contractual term of the nonvested restricted stock units is 3 years as of September 30, 2008.

**4. Investments**

Investments as of September 30, 2008 and December 31, 2007 included available-for-sale securities. At September 30, 2008 and December 31, 2007, the Company held investments in United States Treasury Bills totaling \$10.0 million and \$0.0 million, respectively. These investments are classified as current assets in Investments on the Consolidated Balance Sheets.

Investments were as follows at September 30, 2008 (in thousands):

	Cost	Amortized Discount	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Market Value
Available-for-sale securities	\$9,907	\$ 67	\$24	\$	\$ 9,998

**Table of Contents****5. Property and Equipment**

Property and equipment consist of the following (in thousands):

	September 30, 2008	December 31, 2007
Furniture and equipment	\$ 3,401	\$ 3,314
Computer equipment	1,149	1,147
Capitalized software costs	744	717
Leasehold improvements	6,030	6,038
Subtotal	11,324	11,216
Less accumulated depreciation and amortization	(5,693)	(4,427)
	<b>\$ 5,631</b>	<b>\$ 6,789</b>

As of September 30, 2008, the Company has recorded, within furniture and equipment, office equipment under capital leases of \$0.3 million, including accumulated amortization of \$0.2 million, which is included within depreciation and amortization expense on the accompanying Consolidated Statements of Income. As of December 31, 2007, the Company has recorded office equipment under capital leases of \$0.3 million, including accumulated amortization of \$0.1 million. See Note 8 for discussion of the related capital lease obligations.

**6. Intangible Assets**

The Company's intangible assets are summarized as follows (in thousands):

	September 30, 2008			December 31, 2007		
	Gross Carrying Amount	Accumulated Amortization	Net Book Value	Gross Carrying Amount	Accumulated Amortization	Net Book Value
Amortizable intangible assets:						
Mortgage servicing rights	\$ 8,783	\$ (1,971)	\$ 6,812	\$ 6,085	\$ (742)	\$ 5,343
Deferred financing costs	523	(314)	209	523	(197)	326
Non-compete agreement	100	(23)	77			
Unamortizable intangible assets:						
FINRA license	100		100	100		100
Total intangible assets	<b>\$ 9,506</b>	<b>\$ (2,308)</b>	<b>\$ 7,198</b>	<b>\$ 6,708</b>	<b>\$ (939)</b>	<b>\$ 5,769</b>

As of September 30, 2008 and December 31, 2007, the Company serviced \$24.3 billion and \$23.2 billion, respectively, of commercial loans. The Company earned \$3.5 million and \$9.5 million in servicing fees and interest on float and escrow balances for the three and nine month periods ending September 30, 2008, respectively. The Company earned \$3.5 million and \$10.2 million in servicing fees and interest on float and escrow balances for the three and nine month periods ending September 30, 2007, respectively. These revenues are recorded as capital markets services revenues in the Consolidated Statements of Income.

The total commercial loan servicing portfolio includes loans for which there are no corresponding mortgage servicing rights recorded on the balance sheet, as these servicing rights were assumed prior to January 1, 2007 and involved no initial consideration paid by the Company. The Company has recorded mortgage servicing rights of \$6.8 million and \$5.3 million on \$10.5 billion and \$7.9 billion, respectively, of the total loans serviced as of September 30, 2008 and

December 31, 2007.

The Company stratifies its servicing portfolio based on the type of loan, including life company loans, commercial mortgage backed securities (CMBS), Freddie Mac and limited-service life company loans.

Mortgage servicing rights do not trade in an active, open market with readily available observable prices. Since there is no ready market value for the mortgage servicing rights, such as quoted market prices or prices based on sales or purchases of similar assets, the Company determines the fair value of the mortgage servicing rights by estimating the present value of future cash flows associated with the servicing of the loans. Management makes certain assumptions and judgments in estimating the fair value of servicing rights. The estimate is based on a number of assumptions, including the benefits of servicing (contractual servicing fees and interest on escrow and float balances), the cost of servicing, prepayment rates (including risk of default), an inflation rate, the expected life of the cash flows and the discount rate. The significant assumptions utilized to value servicing rights as of September 30, 2008 are as follows:

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Expected life of cash flows: 3 years to 10 years

Discount rate<sup>(1)</sup>: 15% 20%

Prepayment rate: 0% 7%

Inflation rate: 2%

Cost to service: \$1,600 \$4,004

(1) Reflects the time value of money and the risk of future cash flows related to the possible cancellation of servicing contracts, transferability restrictions on certain servicing contracts, concentration in the life company portfolio and large loan risk.

The above assumptions are subject to change based on management's judgments and estimates of future changes in the risks related to future cash flows and interest rates. Changes in these factors would cause a corresponding increase or decrease in the prepayment rates and discount rates used in our valuation model.

Changes in the carrying value of mortgage servicing rights for the nine month period ended September 30, 2008 and 2007, and the fair value at the end of each period were as follows:

<b>Category</b>	<b>12/31/07</b>	<b>Capitalized</b>	<b>Amortized</b>	<b>Impairment</b>	<b>9/30/08</b>	<b>FV at 9/30/08</b>
Freddie Mac	\$ 2,183	\$ 1,562	\$ (620)	\$	\$ 3,125	\$ 3,635
CMBS	2,414	468	(291)		2,591	2,840
Life company limited	112	128	(48)		192	250
Life company	634	541	(271)		904	1,134
<b>Total</b>	<b>\$ 5,343</b>	<b>\$ 2,699</b>	<b>\$ (1,230)</b>	<b>\$</b>	<b>\$ 6,812</b>	<b>\$ 7,859</b>

<b>Category</b>	<b>12/31/06</b>	<b>Capitalized</b>	<b>Amortized</b>	<b>Impairment</b>	<b>9/30/07</b>	<b>FV at 9/30/07</b>
Freddie Mac	\$ 600	\$ 704	\$ (171)	\$	\$ 1,133	\$ 1,247
CMBS		1,409	(148)		1,261	1,333
Life company limited						
Life company	1,790	638	(573)		1,855	2,286
<b>Total</b>	<b>\$ 2,390</b>	<b>\$ 2,751</b>	<b>\$ (892)</b>	<b>\$</b>	<b>\$ 4,249</b>	<b>\$ 4,866</b>

Amounts capitalized represent mortgage servicing rights retained upon the sale of originated loans to Freddie Mac and mortgage servicing rights acquired without the exchange of initial consideration. The Company recorded mortgage servicing rights retained upon the sale of originated loans to Freddie Mac of \$1.0 million and \$1.6 million on \$270.0 million and \$496.7 million of loans, respectively, during the three and nine month periods ending September 30, 2008 and \$0.3 million and \$0.7 million on \$44.0 million and \$279.4 million of loans, respectively, during the three and nine month periods ending September 30, 2007. The Company recorded mortgage servicing rights acquired without the exchange of initial consideration of \$0.5 million and \$1.1 million on \$939.2 million and \$2.3 billion of loans, respectively, during the three and nine month periods ending September 30, 2008 and \$1.1 million and \$2.0 million on \$2.2 billion and \$4.7 billion of loans, respectively, during the three and nine month periods ending September 30, 2007. These amounts are recorded in Interest and Other Income, net in the Consolidated Statements of Income.

Amortization expense related to intangible assets was \$0.7 million and \$1.4 million during the three and nine month periods ended September 30, 2008, respectively and \$0.5 million and \$1.0 million during the three and nine month periods ended September 30, 2007, respectively and is recorded in Depreciation and Amortization in the Consolidated Statements of Income.

See Note 2 for further discussion regarding treatment of servicing rights prior to January 1, 2007.

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Estimated amortization expense for the next five years is as follows (in thousands):

Remainder of 2008	\$ 454
2009	1,693
2010	1,273
2011	846
2012	711
2013	669

The weighted-average life of the mortgage servicing rights intangible asset was seven years at September 30, 2008. The remaining lives of the deferred financing costs and non-compete agreement intangible assets were one and two years, respectively, at September 30, 2008.

**7. Fair Value Measurement**

As described in Note 2, the Company adopted SFAS 157 as of January 1, 2008. SFAS 157 establishes a valuation hierarchy for disclosure of the inputs to valuation used to measure fair value. This hierarchy prioritizes the inputs into the following three levels: Level 1 inputs which are quoted market prices in active markets for identical assets or liabilities; Level 2 inputs which are observable market-based inputs or unobservable inputs corroborated by market data for the asset or liability, and Level 3 inputs which are unobservable inputs based on our own assumptions that are not corroborated by market data. A financial asset or liability's classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

The Company's Available for Sale Securities are measured at fair value and are classified within Level 1 of the valuation hierarchy. The Company had an unrealized gain of \$21,000, net of tax, on the available for sale securities in the period ended September 30, 2008, which is recorded in Accumulated other comprehensive income, net of tax on the Consolidated Balance Sheets.

The following table presents fair value measurements for major categories of the Company's financial assets measured at fair value on a recurring basis at September 30, 2008 (in thousands):

	Quoted Prices (Level 1)	Fair Value Measurements Using Significant		Total
		Other Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Available-for-sale securities	\$ 9,998	\$	\$	\$ 9,998
Total investments	\$ 9,998	\$	\$	\$ 9,998

In accordance with generally accepted accounting principles, from time to time, the Company measures certain assets at fair value on a nonrecurring basis. These assets may include mortgage servicing rights and mortgage notes receivable. The mortgage servicing rights were not measured at fair value during the third quarter of 2008 as the Company continues to utilize the amortization method under SFAS 156 and the fair value of the mortgage servicing rights exceeds the carrying value at September 30, 2008. See Note 6 for further discussion on the assumptions used in valuing the mortgage servicing rights and impact on earnings during the period. The fair value of the mortgage notes receivable was based on prices observable in the market for similar loans and equaled carrying value at September 30, 2008. Therefore, no lower of cost or fair value adjustment was required.



**Table of Contents****8. Long-Term Debt and Capital Lease Obligations**

Long-term debt and capital lease obligations consist of the following at September 30, 2008 and December 31, 2007 (in thousands):

	September 30, 2008	December 31, 2007
Bank term note payable	\$	\$
Capital lease obligations	165	189
Total long-term debt and capital leases	165	189
Less current maturities	92	78
Long-term debt and capital leases	\$ 73	\$ 111

**(a) The Credit Agreement**

On February 5, 2007, the Company entered into an Amended and Restated Credit Agreement with Bank of America ( Amended Credit Agreement ). The Amended Credit Agreement is comprised of a \$40.0 million revolving credit facility, which replaced the old Credit Agreement that was paid off in connection with the initial public offering. The Amended Credit Agreement matures on February 5, 2010 and may be extended for one year based on certain conditions as defined in the agreement. Interest on outstanding balances is payable at the applicable LIBOR rate (for interest periods of one, two, three, six or twelve months) plus 200 basis points, 175 basis points or 150 basis points (such rate is determined from time to time in accordance with the Amended Credit Agreement, based on our then applicable consolidated leverage ratio) or at interest equal to the higher of (a) the Federal Funds Rate (2.03% at September 30, 2008) plus 0.5% and (b) the Prime Rate (5.0% at September 30, 2008) plus 1.5%. The Amended Credit Agreement also requires payment of a commitment fee of 0.2% or 0.3% on the unused amount of credit based on the total amount outstanding. The Company did not borrow on this revolving credit facility during the period February 5, 2007 through September 30, 2008. As of September 30, 2008, based on Availability, as defined under the Amended Credit Agreement as three times the difference of Consolidated EBITDA, as defined therein, and Consolidated Fixed Charges, as defined therein, the Company has \$30.0 million of the \$40.0 million in undrawn line of credit available under this facility. On October 30, 2007, the Company entered into an amendment to the Amended Credit Agreement to clarify that the \$40.0 million line of credit under the Amended Credit Agreement is available to the Company for purposes of originating such Freddie Mac loans (see discussion under Note 9 below). Additionally, on June 27, 2008, the Company entered into an amendment to the Amended Credit Agreement to modify the calculation of the Consolidated Fixed Charge Coverage Ratio, as defined therein, as it relates to the Quarterly Tax Distributions, as defined therein, and to modify certain annual and quarterly reporting obligations of HFF LP under the Amended Credit Agreement.

**(b) Letters of Credit and Capital Lease Obligations**

At September 30, 2008 and December 31, 2007, the Company has outstanding letters of credit of approximately \$0.2 million with the same bank as the revolving credit arrangements as security for two leases. The Company segregated cash in a separate bank account to collateralize the letters of credit. The letters of credit expire through 2009 but can be extended for one year.

Capital lease obligations consist of office equipment leases that expire at various dates through May 2011 and bear interest at rates ranging from 3.65% to 9.00%. A summary of future minimum lease payments under capital leases at September 30, 2008, is as follows (in thousands):

Remainder of 2008	\$ 22
2009	88
2010	51

2011

4

\$ 165

16

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**Table of Contents****9. Warehouse Line of Credit**

In 2005, HFF LP obtained an uncommitted, unlimited warehouse line of credit for the purpose of funding the Freddie Mac mortgage loans that it originates. In October 2007, this warehouse line was limited to \$150.0 million. In November 2007, the Company entered into a \$50.0 million line of credit note with an additional warehouse lender to serve as a supplement to the existing warehouse line of credit. The Company also is permitted to use borrowings under the Amended Credit Agreement to originate and subsequently sell mortgages in connection with the Company's participation in Freddie Mac's Multifamily Program Plus ® Seller/Servicer program. Each funding is separately approved on a transaction-by-transaction basis and is collateralized by a loan and mortgage on a multifamily property that is ultimately purchased by Freddie Mac. As of September 30, 2008 and December 31, 2007, HFF LP had \$100.3 million and \$41.0 million, respectively, outstanding on the warehouse lines of credit and a corresponding amount of mortgage notes receivable. The Company did not borrow under the Amended Credit Agreement in connection with funding the Freddie Mac mortgage loans that it originates or otherwise during the nine months ended September 30, 2008 or the year ended December 31, 2007. Interest on the warehouse lines of credit is at the 30-day LIBOR rate (2.93% and 5.02% at September 30, 2008 and December 31, 2007, respectively) plus a spread. HFF LP is also paid interest on its loan secured by a multifamily loan at the rate in the Freddie Mac note.

**10. Lease Commitments**

The Company leases various corporate offices, parking spaces, and office equipment under noncancelable operating leases. These leases have initial terms of one to ten years. The majority of the leases have termination clauses whereby the term may be reduced by two to seven years upon prior notice and payment of a termination fee by the Company. Total rental expense charged to operations was \$1.4 million and \$4.3 million, respectively during the three and nine month periods ended September 30, 2008 and \$1.6 million and \$4.4 million, respectively during the three and nine month periods ended September 30, 2007.

Future minimum rental payments for the next five years under operating leases with noncancelable terms in excess of one year and without regard to early termination provisions are as follows (in thousands):

Remainder of 2008	\$ 1,258
2009	4,184
2010	3,971
2011	3,235
2012	3,032
2013	1,947
Thereafter	3,688
	\$ 21,315

From time to time the Company subleases certain office space to subtenants which may be canceled at any time. The rental income received from these subleases is included as a reduction of occupancy expenses in the accompanying Consolidated Statements of Income.

The Company also leases certain office equipment under capital leases that expire at various dates through 2011. See Note 5 and Note 8 above for further description of the assets and related obligations recorded under these capital leases at September 30, 2008 and December 31, 2007, respectively.

HFF Holdings is not an obligor, nor does it guarantee any of the Company's leases.

**11. Servicing**

The Company services commercial real estate loans for investors. The servicing portfolio totaled \$24.3 billion and \$23.2 billion at September 30, 2008 and December 31, 2007, respectively.

In connection with its servicing activities, the Company holds funds in escrow for the benefit of mortgagors for hazard insurance, real estate taxes and other financing arrangements. At September 30, 2008 and December 31, 2007, the funds held in escrow totaled \$102.3 million and \$99.8 million, respectively. These funds, and the offsetting liabilities, are not presented in the Company's consolidated financial statements as they do not represent the assets and liabilities

of the Company. Pursuant to the requirements of the various investors for which the Company services loans, the Company maintains bank accounts holding escrow funds, which have balances in excess of the FDIC insurance limit. The fees earned on these escrow funds are reported in capital markets services revenue in the Consolidated Statements of Income.

**Table of Contents****12. Legal Proceedings**

The Company is party to various litigation matters, in most cases involving ordinary course and routine claims incidental to its business. The Company cannot estimate with certainty its ultimate legal and financial liability with respect to any pending matters. In accordance with SFAS 5, *Accounting for Contingencies*, a reserve for estimated losses is recorded when the amount is probable and can be reasonably estimated. However, the Company believes, based on examination of such pending matters, that its ultimate liability will not have a material adverse effect on its business or financial condition.

**13. Income Taxes**

Income tax expense includes current and deferred taxes as follows (in thousands):

	<b>Current</b>	<b>Deferred</b>	<b>Total</b>
Nine Months Ended September 30, 2008:			
Federal	\$ (2,086)	\$ 6,659	\$ 4,573
State	(587)	847	260
	\$ (2,673)	\$ 7,506	\$ 4,833
	<b>Current</b>	<b>Deferred</b>	<b>Total</b>
Nine Months Ended September 30, 2007:			
Federal	\$ 2,135	\$ 3,983	\$ 6,118
State	1,160	561	1,721
	\$ 3,295	\$ 4,544	\$ 7,839

The reconciliation between the income tax computed by applying the U.S. federal statutory rate and the effective tax rate on net income is as follows for the nine months ended September 30, 2008 and 2007 (dollars in thousands):

	<b>September 30, 2008</b>	<b>September 30, 2007</b>
Pre-tax book income	\$ 9,412	\$ 44,375
Less: income earned prior to IPO and Reorganization Transactions		1,893
Less: income allocated to minority interest holder	4,051	24,614
Pre-tax book income after minority interest	\$ 5,361	\$ 17,868

**Income Tax expense**

		<b>Rate</b>
Taxes computed at federal rate	\$ 1,823	34.0%
State and local taxes, net of federal tax benefit	88	1.6%
Effect of deferred tax rate change	4,879	91.0%
Adjustment for prior year's taxes	46	0.9%
Effect of change in valuation allowance	(678)	(12.6)%
Change in income tax benefit payable to stockholder	(1,488)	(27.8)%
Meals and entertainment	131	2.4%
Other	32	0.6%
Income tax expense	\$ 4,833	90.1%

Total income tax expense recorded for the nine months ended September 30, 2008 and 2007, included a benefit of \$0.1 million and expense of \$0.4 million of state and local taxes on income allocated to the minority interest holder, which represents 1.8% and 2.2% of the total effective rate, respectively.

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Deferred income tax assets and liabilities consist of the following at September 30, 2008 and December 31, 2007 (in thousands):

	<b>September 30, 2008</b>	<b>December 31, 2007</b>
Deferred income tax assets:		
Section 754 election tax basis step-up	\$ 138,179	\$ 150,007
Tenant improvements	527	405
Goodwill		27
Restricted stock units	372	204
Compensation		293
Net operating loss	2,370	
Other	100	34
	<b>141,548</b>	150,970
Less: valuation allowance	<b>(15,730)</b>	(18,177)
Deferred income tax asset	<b>125,818</b>	132,793
Deferred income tax liabilities:		
Compensation	(35)	
Goodwill	(83)	
Servicing rights	(1,128)	(830)
Deferred rent	(347)	(211)
Deferred income tax liability	<b>(1,593)</b>	(1,041)
Net deferred income tax asset	<b>\$ 124,225</b>	\$ 131,752

The ultimate realization of deferred tax assets is dependent on the generation of taxable income during the periods in which temporary differences become deductible or during the periods in which net operating losses can be utilized. In evaluating the realizability of the deferred tax assets, management considers all available positive and negative evidence and makes estimates and judgments regarding the level and timing of future taxable income, including reviewing forward-looking analyses. Based on this analysis and other quantitative and qualitative factors, management believes that it is more likely than not that the Company will be able to generate sufficient taxable income to realize a portion of the deferred tax assets resulting from the initial basis step up recognized from the Reorganization Transaction. Deferred tax assets representing the tax benefits to be realized when future payments are made to HFF Holdings under a tax receivable agreement are currently not more likely than not to be realized and, therefore, have a valuation allowance of \$15.7 million recorded against them. See Note 14 for further information regarding the Company's tax receivable agreement with HFF Holdings. The effects of changes in the Company's estimates regarding the realization of the deferred tax assets will be included in net income. Similarly, the effect of subsequent changes in the enacted tax rates will be included in net income.

In June 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement 109, or FIN 48. FIN 48 prescribes recognition and measurement standards for a tax position taken or expected to be taken in a tax return. The evaluation of a tax position in accordance with FIN 48 is a two-step process. The first step is the determination of whether a tax position should be recognized. Under FIN 48, a tax position taken or expected to be taken in a tax return is to be recognized only if the Company determines that it is more-likely-than-not that the tax position will be sustained upon examination by the tax authorities based upon the technical merits of the position. In step two, for those tax positions which should be recognized, the measurement of a

tax position is determined as being the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement. The Company adopted FIN 48 on January 1, 2007, the effect of which was immaterial to the consolidated financial statements. The Company has determined that no unrecognized tax benefits need to be recorded as of September 30, 2008.

The Company will recognize interest and penalties related to unrecognized tax benefits in Interest and other income. There were no interest or penalties recorded in the three and nine month periods ending September 30, 2008 and 2007.



**Table of Contents****14. Tax Receivable Agreement**

In connection with the Reorganization Transactions, HFF LP and HFF Securities made an election under Section 754 of the Internal Revenue Code for 2007, and intend to keep that election in effect for each taxable year in which an exchange of partnership units for shares occurs. The initial sale as a result of the offering increased the tax basis of the assets owned by HFF LP and HFF Securities to their fair market value. This increase in tax basis allows the Company to reduce the amount of future tax payments to the extent that the Company has future taxable income. As a result of the increase in tax basis, the Company is entitled to future tax benefits of \$138.2 million and has recorded this amount as a deferred tax asset on its Consolidated Balance Sheet. The Company has updated its estimate of these future tax benefits based on the changes to the estimated annual effective tax rate for 2007. The Company is obligated, however, pursuant to its tax receivable agreement with HFF Holdings, to pay to HFF Holdings 85% of the amount of cash savings, if any, in U.S. federal, state and local income tax that the Company actually realizes as a result of these increases in tax basis and as a result of certain other tax benefits arising from the Company entering into the tax receivable agreement and making payments under that agreement. For purposes of the tax receivable agreement, actual cash savings in income tax will be computed by comparing the Company's actual income tax liability to the amount of such taxes that it would have been required to pay had there been no increase to the tax basis of the assets of HFF LP and HFF Securities as a result of the initial sale and later exchanges had the Company not entered into the tax receivable agreement.

The Company accounts for the income tax effects and corresponding tax receivable agreement effects as a result of the initial purchase and the sale of units of the Operating Partnerships in connection with the Reorganization Transactions and future exchanges of Operating Partnership units for the Company's Class A shares by recognizing a deferred tax asset for the estimated income tax effects of the increase in the tax basis of the assets owned by the Operating Partnerships, based on enacted tax rates at the date of the transaction, less any tax valuation allowance the Company believes is required. In accordance with Emerging Issues Task Force Issue No. 94-10 Accounting by a Company for the Income Tax Effects of Transactions Among or with its Shareholders under FASB Statement 109 (EITF 94-10), the tax effects of transactions with shareholders that result in changes in the tax basis of a company's assets and liabilities will be recognized in equity. If transactions with shareholders result in the recognition of deferred tax assets from changes in the company's tax basis of assets and liabilities, the valuation allowance initially required upon recognition of these deferred assets will be recorded in equity.

While the actual amount and timing of payments under the tax receivable agreement will depend upon a number of factors, including the amount and timing of taxable income generated in the future, changes in future tax rates and the value of individual assets, the Company has estimated that the payments that will be made to HFF Holdings will be \$108.3 million and has recorded this obligation to HFF Holdings as a liability on the Consolidated Balance Sheets as of September 30, 2008. In conjunction with the filing of the Company's 2007 federal and state tax returns, the benefit for 2007 relating to the Section 754 basis step-up was finalized resulting in \$6.2 million in tax benefits in 2007. As discussed above, the Company is obligated to remit to HFF Holdings 85% of any such cash savings in federal and state tax. As such, during August 2008, the Company paid \$5.3 million to HFF Holdings under this tax receivable agreement. In addition, during the nine months ended September 30, 2008, the tax rates used to measure the deferred tax assets were updated which resulted in a reduction of deferred tax assets of \$4.6 million, which resulted in a reduction in the payable under the tax receivable agreement of \$3.9 million. To the extent the Company does not realize all of the tax benefits in future years, this liability to HFF Holdings may be reduced.

**Table of Contents****15. Supplemental Statements of Income**

The Supplemental Statements of Income set forth in the table below are provided to principally give additional information regarding the Company's changes in ownership interest in the Operating Partnerships that occurred during the nine month period ending September 30, 2007. The changes in the Company's ownership interest in the Operating Partnerships are a result of the initial public offering on January 30, 2007, and the underwriters' exercise of their option to purchase additional shares on February 21, 2007.

HFF, Inc.  
Consolidated Operating Results  
(dollars in thousands, except per share data)

	<b>Period 1/1/07 through 1/30/07</b>	<b>Period 1/31/07 through 2/21/07</b>	<b>Period 2/22/07 through 3/31/07</b>	<b>Three Months Ended March 31, 2007</b>	<b>Three Months Ended June 30, 2007</b>	<b>Three Months Ended Sept. 30, 2007</b>	<b>Nine Months Ended Sept. 30, 2007</b>
Revenue	\$ 17,467	\$ 12,308	\$ 25,770	\$ 55,545	\$ 79,786	\$ 68,029	\$ 203,360
Operating expenses:							
Cost of services	10,817	7,960	14,556	33,333	44,355	39,166	116,854
Operating, administrative and other	4,427	2,863	6,188	13,478	15,174	14,270	42,922
Depreciation and amortization	358	273	389	1,020	878	993	2,891
Total expenses	15,602	11,096	21,133	47,831	60,407	54,429	162,667
Operating income	1,865	1,212	4,637	7,714	19,379	13,600	40,693
Interest and other income	401	169	352	922	994	2,170	4,086
Interest expense	(373)	(14)	(7)	(394)	(6)	(4)	(404)
Income before income taxes and minority interest	1,893	1,367	4,982	8,242	20,367	15,766	44,375
Income tax expense		151	945	1,096	3,796	2,947	7,839
Income before minority interest	1,893	1,216	4,037	7,146	16,571	12,819	36,536
Minority interest		1,029	2,879	3,908	11,513	8,808	24,229
Net income	\$ 1,893	\$ 187	\$ 1,158	\$ 3,238	\$ 5,058	\$ 4,011	\$ 12,307
Less net income earned prior to IPO and reorg	(1,893)			(1,893)			(1,893)
Income available to common stockholders	\$	\$ 187	\$ 1,158	\$ 1,345	\$ 5,058	\$ 4,011	\$ 10,414
Net income per share basic				\$ 0.13	\$ 0.31	\$ 0.24	\$ 0.72
Net income per share diluted				\$ 0.13	\$ 0.31	\$ 0.24	\$ 0.72

**16. Minority Interest**

Minority interest recorded in the consolidated financial statements of HFF, Inc. relates to the ownership interest of HFF Holdings in the Operating Partnerships. As a result of the Reorganization Transactions discussed in Note 1, partners' capital was eliminated from equity and minority interest of \$10.3 million was recorded representing HFF Holdings' remaining interest in the Operating Partnerships following the initial public offering and the underwriter's exercise of the overallotment option on February 21, 2007, along with HFF Holdings' proportional share of net income earned by the Operating Partnership subsequent to the change in ownership. The table below sets forth the minority interest amount recorded during the three and nine month periods ending September 30, 2008 and 2007, which includes the period following the initial public offering on January 30, 2007, and for the period following the underwriter's exercise of the overallotment option on February 21, 2007 (dollars in thousands).

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	<b>Period 1/1/07 through 1/30/07</b>	<b>Period 1/31/07 through 2/21/07</b>	<b>Period 2/22/07 through 3/31/07</b>	<b>Three months ended 3/31/07</b>	<b>Three months ended 6/30/07</b>	<b>Three months ended 9/30/07</b>	<b>Nine months ended 9/30/07</b>
Net income from operating partnerships	\$ 1,922	\$ 1,683	\$ 5,206	\$ 8,811	\$ 20,814	\$ 15,925	\$ 45,550
Minority interest ownership percentage		61.14%	55.31%		55.31%	55.31%	
Minority interest		\$ 1,029	\$ 2,879	\$ 3,908	\$ 11,513	\$ 8,808	\$ 24,229
				<b>Three months ended 3/31/08</b>	<b>Three months ended 6/30/08</b>	<b>Three months ended 9/30/08</b>	<b>Nine months ended 9/30/08</b>
Net (loss) / income from operating partnerships				\$ (177)	\$ 5,265	\$ 2,413	\$ 7,501
Minority interest ownership percentage				55.31%	55.31%	55.31%	55.31%
Minority interest				\$ (98)	\$ 2,912	\$ 1,335	\$ 4,149

**17. Stockholders Equity**

The Company is authorized to issue 175,000,000 shares of Class A common stock, par value \$0.01 per share, and one share of Class B common stock, par value \$0.01 per share. Each share of Class A common stock entitles its holder to one vote on all matters to be voted on by stockholders generally. HFF Holdings has been issued one share of Class B common stock. Class B common stock has no economic rights but entitles the holder to a number of votes equal to the total number of shares of Class A common stock for which the partnership units that HFF Holdings holds in the Operating Partnerships, as of the relevant record date for the HFF, Inc. stockholder action, are exchangeable. Holders of Class A and Class B common stock will vote together as a single class on all matters presented to our stockholders for their vote or approval. The Company has issued 16,446,480 shares and 16,445,000 shares of Class A common stock as of September 30, 2008 and December 31, 2007, respectively. The Company has issued one share of Class B common stock as of September 30, 2008 and December 31, 2007.

**18. Earnings Per Share**

The Company's net income and weighted average shares outstanding for the three and nine month periods ended September 30, 2008 and 2007, consist of the following (*dollars in thousands*):

	<b>Three months ended September 30</b>		<b>Nine months ended September 30</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Net income	\$ 325	\$ 4,011	\$ 430	\$ 12,307
Net income available for Class A common stockholders	\$ 325	\$ 4,011	\$ 430	\$ 10,414
Weighted Average Shares Outstanding:				

Basic	<b>16,481,786</b>	16,456,110	<b>16,464,731</b>	14,467,032
Diluted	<b>16,481,786</b>	16,456,110	<b>16,464,731</b>	14,467,032

Net income per share information is not applicable for reporting periods prior to January 31, 2007, the date of the initial public offering. The calculations of basic and diluted net income per share amounts for the three and nine month periods ended September 30, 2008 and 2007 are described and presented below.

***Basic Net Income per Share***

*Numerator* net income attributable to Class A common stockholders for the three and nine month periods ended September 30, 2008 and 2007, respectively.

*Denominator* the weighted average shares of Class A common stock for the three and nine month periods ended September 30, 2008 and 2007, including 47,730 and 11,110 restricted stock units that have vested and whose issuance is no longer contingent as of September 30, 2008 and September 30, 2007, respectively.

**Table of Contents*****Diluted Net Income per Share***

*Numerator* net income attributable to Class A common stockholders for the three and nine month periods ended September 30, 2008 and 2007 as in the basic net income per share calculation described above plus income allocated to minority interest holder upon assumed exercise of exchange rights.

*Denominator* the weighted average shares of Class A common stock for the three and nine month periods ended September 30, 2008 and 2007, including 47,730 and 11,110 restricted stock units that have vested and whose issuance is no longer contingent as of September 30, 2008 and September 30, 2007, respectively, plus the dilutive effect of the unrestricted stock units, stock options, and the issuance of Class A common stock upon exercise of the exchange right by HFF Holdings.

	<b>Three months ended September 30</b>		<b>Nine months ended September 30</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
<b>Basic Earnings Per Share of Class A Common Stock</b>				
Numerator:				
Net income attributable to Class A common stockholders	\$ 325	\$ 4,011	\$ 430	\$ 10,414
Denominator:				
Weighted average number of shares of Class A common stock outstanding	<b>16,481,786</b>	16,456,110	<b>16,464,731</b>	14,467,032
Basic net income per share of Class A common stock	\$ 0.02	\$ 0.24	\$ 0.03	\$ 0.72
<b>Diluted Earnings Per Share of Class A Common Stock</b>				
Numerator:				
Net income attributable to Class A common stockholders	\$ 325	\$ 4,011	\$ 430	\$ 10,414
Add dilutive effect of:				
Income allocated to minority interest holder upon assumed exercise of exchange right				
Denominator:				
Basic weighted average number of shares of Class A common stock	<b>16,481,786</b>	16,456,110	<b>16,464,731</b>	14,467,032
Add dilutive effect of:				
Unvested restricted stock units				
Stock options				
Minority interest holder exchange right				
Weighted average common shares outstanding diluted	<b>16,481,786</b>	16,456,110	<b>16,464,731</b>	14,467,032
Diluted earnings per share of Class A common stock	\$ 0.02	\$ 0.24	\$ 0.03	\$ 0.72

**19. Related Party Transactions**

The Company made payments on behalf of two affiliates of approximately \$54,000, during the nine month period ended September 30, 2008. The Company had a net receivable from affiliates of \$1.3 million and \$1.2 million at September 30, 2008 and December 31, 2007, respectively.

During the nine months ended September 30, 2007, the Company made payments of \$1.2 million and allocated expenses for services performed of \$0.1 million on behalf of two affiliates. The Company was reimbursed for

transaction costs relating to the IPO transaction from its two affiliates of approximately \$1.5 million during the nine months ended September 30, 2007. In addition, the Company recorded a payable to its two affiliates in the amount of \$10.9 million during the nine months ended September 30, 2007 for net working capital adjustments, the release of a letter of credit as a result of the IPO transaction, and tax distributions. Upon release of the letter of credit, the Company made a payment to an affiliate in the amount of \$2.0 million during the nine months ended September 30, 2007. The Company had a net payable to affiliates of \$6.1 million at September 30, 2007.

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As a result of the Company's initial public offering, the Company entered into a tax receivable agreement with HFF Holdings that provides for the payment by the Company to HFF Holdings of 85% of the amount of the cash savings, if any, in U.S. federal, state and local income tax that the Company actually realizes as a result of the increase in tax basis of the assets owned by HFF LP and HFF Securities and as a result of certain other tax benefits arising from entering into the tax receivable agreement and making payments under that agreement. The Company will retain the remaining 15% of cash savings, if any, in income tax that it realizes. For purposes of the tax receivable agreement, cash savings in income tax will be computed by comparing the Company's actual income tax liability to the amount of such taxes that it would have been required to pay had there been no increase to the tax basis of the assets of HFF LP and HFF Securities allocable to the Company as a result of the initial sale and later exchanges and had the Company not entered into the tax receivable agreement. The term of the tax receivable agreement commenced upon consummation of the offering and will continue until all such tax benefits have been utilized or have expired. During the three month period ended September 30, 2008, the Company made a payment of \$5.3 million to HFF Holdings representing the first payment under the tax receivable agreement. See Note 14 for further information regarding the tax receivable agreement and Note 20 for the amount recorded in relation to this agreement.

**20. Commitments and Contingencies**

The Company is obligated, pursuant to its tax receivable agreement with HFF Holdings, to pay to HFF Holdings 85% of the amount of cash savings, if any, in U.S. federal, state and local income tax that the Company actually realizes as a result of the increases in tax basis under Section 754 and as a result of certain other tax benefits arising from the Company entering into the tax receivable agreement and making payments under that agreement. During the third quarter of 2008, the Company paid HFF Holdings \$5.3 million, which represents 85% of the actual cash savings realized by the Company in 2007. The Company has recorded \$108.3 million for this obligation to HFF Holdings as a liability on the Consolidated Balance Sheet as of September 30, 2008.



**Table of Contents****Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion summarizes the financial position of HFF, Inc. and its subsidiaries as of September 30, 2008, and the results of our operations for the three and nine month periods ended September 30, 2008, and should be read in conjunction with (i) the unaudited consolidated financial statements and notes thereto included elsewhere in this Quarterly Report on Form 10-Q and (ii) the consolidated financial statements and accompanying notes to our Annual Report on Form 10-K for the year ended December 31, 2007.

**Overview***Our Business*

We are a leading provider of commercial real estate and capital markets services to the U.S. commercial real estate industry based on transaction volume and are one of the largest full-service commercial real estate financial intermediaries in the country.

Substantially all of our revenues are in the form of capital markets services fees collected from our clients, usually negotiated on a transaction-by-transaction basis. We also earn fees from commercial loan servicing activities. We believe that our multiple product offerings, diverse client mix, expertise in a wide range of property types and national platform create diversified revenue stream. Furthermore, we believe our business mix, operational expertise and the leveragability of our platform have enabled us, in the past, to achieve profit margins that are among the highest of our public company peers.

We operate in one reportable segment, the commercial real estate financial intermediary segment, and offer debt placement, investment sales, structured finance, equity placement, investment banking and advisory services, note sales and note sale advisory services and commercial loan servicing.

Our business has been and may continue to be significantly affected by factors outside of our control, particularly including:

***Economic and commercial real estate market downturns.*** Our business is dependent on international and domestic economic conditions and the demand for commercial real estate and related services in the markets in which we operate and a slow down, a significant downturn and/or a recession in either the global economy and/or the domestic economy, including but not limited to even a regional economic downturn could adversely affect our business. A general decline in acquisition and disposition activity can lead to a reduction in fees and commissions for arranging such transactions, as well as in fees and commissions for arranging financing for acquirers and property owners that are seeking to recapitalize their existing properties. Likewise, a general decline in commercial real estate investment activity can lead to a reduction in fees and commissions for arranging acquisitions, dispositions and financings for acquisitions as well as for recapitalizations for existing property owners as well as a significant reduction in our loan servicing activities, due to increased delinquencies and defaults and lack of additional loans that we would have otherwise added to our loan servicing portfolio, all of which would have an adverse effect on our business.

***Global and domestic credit and liquidity issues.*** Global and domestic credit and liquidity issues have led to and are expected to continue to lead to a decrease in transaction activity and lower values. The current situation in the global credit markets whereby many world governments (including but not limited to the U.S. where the Company transacts virtually all of its business) have had to take unprecedented and uncharted steps to support the financial institutions in their respective countries from collapse is unprecedented in the Company's history. Restrictions on the availability of capital, both debt and/or equity, have created significant reductions and could further reduce the liquidity in and flow of capital to the commercial real estate markets, as is currently the case. These restrictions could also cause commercial real estate prices to decrease due to the reduced amount of equity capital and debt financing available, as is currently the case. In particular, global and domestic credit and liquidity issues may reduce the number of acquisitions, dispositions and loan originations, as well as the respective number of transactions and transaction volumes, which could also adversely affect our capital markets services revenues including our servicing revenue, as is currently the case.

***Decreased investment allocation to commercial real estate class.*** Allocations to commercial real estate as an asset class for investment portfolio diversification may decrease for a number of reasons beyond our control, including but not limited to poor performance of the asset class relative to other asset classes, superior performance of other asset classes when compared with continued good performance of the commercial real

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estate asset class or when allocations must be reduced due to the overall poor performance of an investor's portfolio causing the allocations to commercial real estate to exceed the target allocation. In addition, while commercial real estate had been recently viewed as an accepted and valid class for portfolio diversification, if this perception changes, which may be the case today, there could be a significant reduction in the amount of debt and equity capital available in the commercial real estate sector.

***Fluctuations in interest rates.*** Significant fluctuations in interest rates as well as steady and protracted movements of interest rates in one direction (increases or decreases) could adversely affect the operation and income of commercial real estate properties as well as the demand from investors for commercial real estate investments. Both of these events could adversely affect investor demand and the supply of capital for debt and equity investments in commercial real estate. In particular, increased interest rates may cause prices to decrease due to the increased costs of obtaining financing and could lead to decreases in purchase and sale activities thereby reducing the amounts of investment sales and loan originations and related servicing fees. If our investment sales origination and servicing businesses are negatively impacted, it is likely that our other lines of business would also suffer due to the relationship among our various capital markets services.

The factors discussed above continue to be a risk to our business as evidenced by the recent significant disruptions in the global capital and credit markets, especially in the domestic capital markets. In particular, the liquidity issues in the capital markets have adversely affected our business and could continue to adversely affect our business. The significant balance sheet issues of many of the CMBS lenders, banks, life insurance companies, captive finance companies and other financial institutions have, and may likely continue to, adversely affect the flow of commercial mortgage debt and equity to the U.S. capital markets as well and can potentially adversely affect all of our capital markets services platforms and resulting revenues.

The economic slow down, as well as deflation, and possible recession globally, and especially in the United States also continues to be a risk, not only due to the current and potential negative adverse impacts on the performance of U.S. commercial real estate markets, but also to the ability of lenders and equity investors to generate significant funds to continue to make loans and equity available to the U.S. commercial real estate market.

Other factors that may adversely affect our business are discussed under the heading "Forward-Looking Statements" and under the caption "Risk Factors" in this Quarterly Report on Form 10-Q.

**Table of Contents****Results of Operations**

Following is a discussion of our results of operations for the three months ended September 30, 2008 and September 30, 2007. The table included in the period comparisons below provides summaries of our results of operations. The period-to-period comparisons of financial results are not necessarily indicative of future results.

	For the Three Months Ended		September 30,		Total Dollar Change	Total Percentage Change
	2008		2007			
	Dollars	% of Revenue	Dollars	% of Revenue		
<i>(dollars in thousands, unless percentages)</i>						
Revenues						
Capital markets services revenue	\$29,441	94.9%	\$66,463	97.7%	\$(37,022)	(55.7)%
Interest on mortgage notes receivable	698	2.2%	246	0.4%	452	183.7%
Other	895	2.9%	1,320	1.9%	(425)	(32.2)%
Total revenues	31,034	100.0%	68,029	100.0%	(36,995)	(54.4)%
Operating expenses						
Cost of services	20,014	64.5%	39,166	57.6%	(19,152)	(48.9)%
Personnel	2,160	7.0%	4,605	6.8%	(2,445)	(53.1)%
Occupancy	1,930	6.2%	2,134	3.1%	(204)	(9.6)%
Travel and entertainment	970	3.1%	991	1.5%	(21)	(2.1)%
Supplies, research and printing	1,523	4.9%	2,655	3.9%	(1,132)	(42.6)%
Other	4,535	14.6%	4,878	7.2%	(343)	(7.0)%
Total operating expenses	31,132	100.3%	54,429	80.0%	(23,297)	(42.8)%
Operating (loss) / income	(98)	(0.3)%	13,600	20.0%	(13,698)	(100.7)%
Interest and other income	1,849	6.0%	2,170	3.2%	(321)	(14.8)%
Interest expense	(4)	(0.0)%	(4)	(0.0)%		0.0%
Decrease in payable under tax receivable agreement	282	0.9%		0.0%	282	100.0%
Income before income taxes and minority interest	2,029	6.5%	15,766	23.2%	(13,737)	(87.1)%
Income tax expense	369	1.2%	2,947	4.3%	(2,578)	(87.5)%
Income before minority interest	1,660	5.3%	12,819	18.8%	(11,159)	(87.1)%

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Minority interest	1,335	4.3%	8,808	12.9%	(7,473)	(84.8)%
Net income	\$ 325	1.0%	\$ 4,011	5.9%	\$ (3,686)	(91.9)%

*Revenues.* Our total revenues were \$31.0 million for the three months ended September 30, 2008 compared to \$68.0 million for the same period in 2007, a decrease of \$37.0 million, or 54.4%. Revenues decreased primarily as a result of the decrease in production volumes in several of our capital markets services platforms brought about, in significant part, by a slowing economy, both globally and domestically as well as from the unprecedented disruptions in the global and domestic capital and credit markets.

The revenues we generated from capital markets services for the three months ended September 30, 2008 decreased \$37.0 million, or 55.7%, to \$29.4 million from \$66.5 million for the same period in 2007. The decrease is primarily attributable to a decrease in both the number and the average dollar value of transactions closed during the third quarter of 2008 compared to the third quarter of 2007.

The revenues derived from interest on mortgage notes receivable were \$0.7 million for the three months ended September 30, 2008 compared to \$0.2 million for the same period in 2007, an increase of \$0.5 million. Revenues increased primarily as a result of increased volume of Freddie Mac loans in the third quarter of 2008 compared to the third quarter of 2007.

The other revenues we earned, which include expense reimbursements from clients related to out of pocket costs incurred, were approximately \$0.9 million for the three month period ended September 30, 2008 and \$1.3 million for the three month period ending September 30, 2007. The decrease is primarily due to the decrease in the number of transactions closed during the third quarter 2008 compared to the third quarter of 2007.

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*Total Operating Expenses.* Our total operating expenses were \$31.1 million for the three months ended September 30, 2008 compared to \$54.4 million for the same period in 2007, a decrease of \$23.3 million, or 42.8%. Expenses decreased primarily due to lower cost of services, personnel and supplies, research and printing costs as a result of the reduction in capital markets services revenue.

The costs of services for the three months ended September 30, 2008 decreased \$19.2 million, or 48.9%, to \$20.0 million from \$39.2 million for the same period in 2007. The decrease is primarily the result of the decrease in commissions and other incentive compensation directly related to the decrease in capital markets services revenues. Cost of services as a percentage of capital markets services and other revenues were approximately 66.0% and 57.8% for the three month periods ended September 30, 2008 and September 30, 2007, respectively. This percentage increase is primarily attributable to the fixed portion of cost of services, such as salaries for our analysts and fringe benefit costs being spread over a lower revenue base.

Personnel expenses that are not directly attributable to providing services to our clients for the three months ended September 30, 2008 decreased \$2.4 million, or 53.1%, to \$2.2 million from \$4.6 million for the same period in 2007. The decrease is primarily related to a decrease in profit participation expense resulting from the lower operating income during the three months ended September 30, 2008.

Occupancy, travel and entertainment, and supplies, research and printing expenses for the three months ended September 30, 2008 decreased \$1.4 million, or 23.5%, to \$4.4 million compared to the same period in 2007. These decreases are primarily due to decreased supplies, research and printing expenses stemming from the decrease in capital markets services revenues.

Other expenses, including costs for insurance, professional fees, depreciation and amortization, interest on our warehouse line of credit and other operating expenses, were \$4.5 million in the three months ended September 30, 2008, a decrease of \$0.3 million, or 7.0%, versus \$4.9 million in the three months ended September 30, 2007. This decrease is primarily related to decreased professional fees, other taxes and gain on sale of assets in the total amount of \$0.8 million. This decrease was partially offset by an increase in production interest expense of \$0.3 million.

*Net Income.* Our net income for the three months ended September 30, 2008 was \$0.3 million, a decrease of \$3.7 million versus income of \$4.0 million for the same fiscal period in 2007. We attribute this decrease to several factors, with the most significant cause being the reduction in revenues of \$37.0 million. Factors slightly offsetting this decrease included:

The decrease in the payable under the tax receivable agreement of \$282,000 reflects the decrease in the estimated tax benefits owed to HFF Holdings under the tax receivable agreement. This decrease in tax benefits owed to HFF Holdings represents 85% of the decrease in the related deferred tax asset of \$333,000.

During the three months ended September 30, 2008, the Company recorded a current income tax expense of \$0.7 million and deferred income tax benefit of \$0.3 million as compared to current income tax expense of \$1.1 million and deferred income tax expense of \$1.8 million during the three months ended September 30, 2007.

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Following is a discussion of our results of operations for the nine months ended September 30, 2008 and September 30, 2007. The table included in the period comparisons below provides summaries of our results of operations. The period-to-period comparisons of financial results are not necessarily indicative of future results.

	For the Nine Months Ended		September 30,		Total Dollar Change	Total Percentage Change
	2008		2007			
	Dollars	% of Revenue	Dollars	% of Revenue		
(dollars in thousands, unless percentages)						
Revenues						
Capital markets services revenue	\$ 103,003	96.4%	\$ 199,565	98.1%	\$(96,562)	(48.4)%
Interest on mortgage notes receivable	1,421	1.3%	1,081	0.5%	340	31.5%
Other	2,379	2.2%	2,714	1.4%	(335)	(12.3)%
Total revenues	106,803	100.0%	203,360	100.0%	(96,557)	(47.5)%
Operating expenses						
Cost of services	69,365	64.9%	116,854	57.5%	(47,489)	(40.6)%
Personnel	7,018	6.6%	14,307	7.0%	(7,289)	(50.9)%
Occupancy	5,689	5.3%	6,012	3.0%	(323)	(5.4)%
Travel and entertainment	4,855	4.5%	4,635	2.3%	220	4.7%
Supplies, research and printing	5,841	5.5%	6,703	3.3%	(862)	(12.9)%
Other	12,245	11.5%	14,156	7.0%	(1,911)	(13.5)%
Total operating expenses	105,013	98.3%	162,667	80.0%	(57,654)	(35.4)%
Operating income	1,790	1.7%	40,693	20.0%	(38,903)	(95.6)%
Interest and other income	3,775	3.5%	4,086	2.0%	(311)	(7.6)%
Interest expense	(15)	(0.0)%	(404)	(0.2)%	389	(96.3)%
Decrease in payable under the tax receivable agreement	3,862	3.6%		0.0%	3,862	100.0%
Income before income taxes and minority interest	9,412	8.8%	44,375	21.8%	(34,963)	(78.8)%
Income tax expense	4,833	4.5%	7,839	3.9%	(3,006)	(38.3)%
Income before minority interest	4,579	4.3%	36,536	18.0%	(31,957)	(87.5)%
Minority interest	4,149	3.9%	24,229	11.9%	(20,080)	(82.9)%
Net income	\$ 430	0.4%	\$ 12,307	6.1%	\$(11,877)	(96.5)%

*Revenues.* Our total revenues were \$106.8 million for the nine months ended September 30, 2008 compared to \$203.4 million for the same period in 2007, a decrease of \$96.6 million, or 47.5%. Revenues decreased primarily as a result of the decrease in production volumes in several of our capital markets services platforms attributable to, in significant part, by a slowing economy, both globally and domestically as well as from the unprecedented disruptions in the global and domestic capital and credit markets.

The revenues we generated from capital markets services for the nine months ended September 30, 2008 decreased \$96.6 million, or 48.4%, to \$103.0 million from \$199.6 million for the same period in 2007. The decrease is primarily attributable to a decrease in both the number and the average dollar value of transactions closed during the first nine months of 2008 compared to the first nine months of 2007.

The revenues derived from interest on mortgage notes receivable were \$1.4 million for the nine months ended September 30, 2008 compared to \$1.1 million for the same period in 2007, an increase of \$0.3 million. Revenues increased primarily as a result of increased volume of Freddie Mac loans in the first nine months of 2008 compared to the first nine months of 2007.

The other revenues we earned, which include expense reimbursements from clients related to out of pocket costs incurred, were approximately \$2.4 million for the nine month period ended September 30, 2008 and \$2.7 million for the nine month period ending September 30, 2007.

*Total Operating Expenses.* Our total operating expenses were \$105.0 million for the nine months ended September 30, 2008 compared to \$162.7 million for the same period in 2007, a decrease of \$57.7 million, or 35.4%. Expenses decreased primarily due to lower cost of services and personnel costs as a result of the reduction in capital markets services revenue, and decreased professional fees and supplies, research and printing costs.



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The costs of services for the nine months ended September 30, 2008 decreased \$47.5 million, or 40.6%, to \$69.4 million from \$116.9 million for the same period in 2007. The decrease is primarily the result of the decrease in commissions and other incentive compensation directly related to the decrease in capital markets services revenues. Cost of services as a percentage of capital markets services and other revenues were approximately 65.8% and 57.8% for the nine month periods ended September 30, 2008 and September 30, 2007, respectively. This percentage increase is primarily attributable to the fixed portion of cost of services, such as salaries for our analysts and fringe benefit costs, being spread over a lower revenue base.

Personnel expenses that are not directly attributable to providing services to our clients for the nine months ended September 30, 2008 decreased \$7.3 million, or 50.9%, to \$7.0 million from \$14.3 million for the same period in 2007. The decrease is primarily related to a decrease in profit participation expense resulting from the lower operating income during the nine months ended September 30, 2008. This decrease was slightly offset by increased salaries of \$0.5 million during the nine months ended September 30, 2008 as compared to the same period in the prior year.

Other expenses, including costs for insurance, professional fees, depreciation and amortization, interest on our warehouse line of credit and other operating expenses, were \$12.2 million in the nine months ended September 30, 2008, a decrease of \$1.9 million, or 13.5%, versus \$14.2 million in the nine months ended September 30, 2007. This decrease is primarily related to decreases in professional fees and marketing expenses. The Company experienced higher professional fees of approximately \$0.9 million during the nine month period ended September 30, 2007 primarily as a consequence of fees related to the Company's initial public offering that were incurred during this period. Marketing expenses decreased \$0.8 million due to a decrease in corporate and local advertising and corporate-sponsored events.

*Net Income.* Our net income for the nine months ended September 30, 2008 was \$0.4 million, a decrease of \$11.9 million versus net income of \$12.3 million for the same fiscal period in 2007. We attribute this decrease to several factors, with the most significant cause being a decrease of revenues of \$96.6 million related to current year market conditions and the resulting lower operating income. Factors slightly offsetting this decrease included:

The interest expense we incurred in the nine months ended September 30, 2008 totaled \$15,000, compared to \$0.4 million of similar expenses incurred in the nine months ended September 30, 2007. This decrease resulted from interest expense in the amount of \$0.4 million on a Credit Agreement with Bank of America in the three months ended March 31, 2007. The outstanding balance of \$56.3 million under this Credit Agreement was paid off with the proceeds from the initial public offering and we contemporaneously entered into an Amended Credit Agreement with Bank of America providing for our current \$40.0 million line of credit.

The decrease in the payable under the tax receivable agreement of \$3.9 million reflects the decrease in the estimated tax benefits owed to HFF Holdings under the tax receivable agreement. This decrease in tax benefits owed to HFF Holdings represents 85% of the decrease in the related deferred tax asset of \$4.6 million.

Income tax expense was approximately \$4.8 million for the nine months ended September 30, 2008, a decrease of \$3.0 million from \$7.8 million in the nine months ended September 30, 2007. This decrease is primarily due to the decrease in net operating income experienced during the nine months ended September 30, 2008 compared to the same period in the prior year. During the nine months ended September 30, 2008, the Company recorded a current income tax benefit of \$2.7 million which was offset by deferred income tax expense of \$7.5 million, primarily relating to the amortization of the step-up in basis from the Section 754 election and a change in the rates used to measure the deferred tax assets. During the nine months ended September 30, 2007, the Company recorded current income tax expense of \$3.3 million and deferred income tax expense of \$4.5 million.

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**Financial Condition**

Total assets increased to \$289.5 million at September 30, 2008, from \$240.5 million at December 31, 2007, primarily due to:

An increase in prepaids and other assets of \$4.6 million primarily the result of the recording of a current income tax benefit of \$2.7 million during the nine months ending September 30, 2008 and payment of annual insurance premiums.

An increase in mortgage notes receivable of \$59.3 million due to a higher number of loans pending sale to Freddie Mac at September 30, 2008, compared to December 31, 2007.

These increases were partially offset by a \$7.5 million decrease in the deferred tax asset primarily as a result of the amortization of the step-up in basis from the section 754 election.

Total liabilities increased \$43.8 million at September 30, 2008, from \$180.6 million at December 31, 2007, primarily due to an increase in the warehouse line of credit of \$59.3 million due to a higher balance of loans pending sale to Freddie Mac at September 30, 2008, compared to December 31, 2007.

This increase was partially offset by the following:

A decrease in accrued compensation and related taxes of \$4.6 million due to payment of year end bonus accruals and a lower profit participation accrual at September 30, 2008 as compared to September 30, 2007.

A decrease in the payable under the tax receivable agreement of \$3.9 million representing 85% of the decrease in our deferred tax assets which decreased due to a change in the tax rate used to measure our deferred tax assets.

Also, in conjunction with the filing of the Company's 2007 federal and state tax returns, the benefit for 2007 relating to the Section 754 basis step-up was finalized resulting in \$6.2 million in tax benefits in 2007. As such, during August 2008, the Company paid \$5.3 million to HFF Holdings under this tax receivable agreement.

**Cash Flows**

Our historical cash flows are primarily related to the timing of receipt of transaction fees, the timing of distributions to members of HFF Holdings and payment of commissions and bonuses to employees.

**2008**

Cash and cash equivalents decreased \$17.0 million in the nine months ended September 30, 2008. Net cash of \$6.7 million was used in operating activities, primarily resulting from a \$4.6 million increase in prepaid expenses and other current assets and a \$4.6 million decrease in accrued compensation and related taxes. These uses of cash were partially offset by the decrease in deferred taxes of \$7.5 million. Cash of \$9.9 million was used to purchase a six month United States Treasury Note and \$0.3 million was used for investing in property and equipment and entering into a non-compete agreement. Financing activities used \$0.1 million of cash for the payments on certain capital leases and distributions to HFF Holdings, the minority interest holder.

**2007**

Cash and cash equivalents increased \$56.2 million in the nine months ended September 30, 2007. Net cash of \$68.0 million was provided by operating activities, primarily resulting from an increase in accrued compensation and related taxes of \$16.6 million and net income (including minority interest) of \$36.5 million. Cash of \$4.3 million was used for investing in property and equipment. Financing activities used \$7.5 million of cash primarily due to the payoff of the credit facility in the amount of \$56.3 million, the purchase of partnership interests in HFF LP and HFF Securities and shares of Holliday GP and distributions to HFF Holdings and its members. This decrease in cash was partially offset by the proceeds from the issuance of our Class A common stock of \$272.1 million.

**Table of Contents****Liquidity and Capital Resources**

Our current assets typically have consisted primarily of cash and accounts receivable in relation to earned transaction fees. Our liabilities have typically consisted of accounts payable and accrued compensation.

Over the nine month period ended September 30, 2008, we used approximately \$6.7 million of cash from operations. Our short-term liquidity needs are typically related to compensation expenses and other operating expenses such as occupancy, supplies, marketing, professional fees and travel and entertainment. For the nine months ended September 30, 2008, we incurred approximately \$105.0 million in total operating expenses. A large portion of our operating expenses are variable, highly correlated to our revenue streams and dependent on the collection of transaction fees. During the nine months ended September 30, 2008, approximately 46.8% of our operating expenses were variable expenses. In addition, our tax receivable agreement with HFF Holdings entered into in connection with our initial public offering, provides for the payment by us to HFF Holdings of 85% of the amount of cash savings, if any, in U.S. federal, state and local income taxes that we actually realize as a result of the increases in tax basis and as a result of certain other tax benefits arising from our entering into the tax receivable agreement and making payments under that agreement. We have estimated that the payments that will be made to HFF Holdings will be \$108.3 million. Our liquidity needs related to our long term obligations are primarily related to our facility leases and payments under the tax receivable agreement. In connection with our initial public offering, we paid off the entire balance of our credit facility of \$56.3 million and entered into a new credit facility that provides us with a \$40.0 million line of credit, as described below. We currently believe that cash flows from operating activities, availability under our line of credit and our existing cash balance will provide adequate liquidity and are sufficient to meet our working capital needs and satisfy our long-term obligations. For the nine months ended September 30, 2008, we incurred approximately \$5.7 million in occupancy expenses and approximately \$15,000 in interest expense.

Our cash flow generated from operations historically has been sufficient to enable us to meet our objectives. Assuming we can generate similar revenues and operating income going forward, we believe that cash flows from operating activities will be sufficient for us to fund our current obligations for the foreseeable future. In addition, we intend to continue to maintain lines of credit that can be utilized to support our activities should the need arise. In the course of the past several years, we have entered into financing arrangements designed to support our liquidity. Our current principal financing arrangements are described below.

We entered into an Amended Credit Agreement with Bank of America, N.A. for a new \$40.0 million line of credit that was put in place contemporaneously with the consummation of the initial public offering. This new credit facility matures on February 5, 2010 and may be extended for one year based on certain conditions as defined in the agreement. Interest on outstanding balance is payable at the applicable LIBOR rate (for interest periods of one, two, three, six or twelve months) plus 200 basis points, 175 basis points or 150 basis points (such rate is determined from time to time in accordance with the Amended Credit Agreement, based on our then applicable consolidated leverage ratio) or at interest equal to the higher of (a) the Federal Funds Rate (2.03% at September 30, 2008) plus 0.5% and (b) the Prime Rate (5.0% at September 30, 2008) plus 1.5%. The Amended Credit Agreement also requires payment of a commitment fee of 0.2% or 0.3% on the unused amount of credit based on the total amount outstanding. Additionally, on June 27, 2008, we entered into an amendment to the Amended Credit Agreement to modify the calculation of the Consolidated Fixed Charge Coverage Ratio, as defined therein, as it relates to the Quarterly Tax Distributions, as defined therein, and to modify certain annual and quarterly reporting obligations of HFF LP under the Amended Credit Agreement. We did not borrow on this revolving credit facility during the nine month period ended September 30, 2008. On October 29, 2008, Bank of America announced plans that they would participate in the U.S. governments Troubled Asset Relief Program (TARP). As of this time, we are unable to determine what impact, if any, this may have on our ability to utilize its line of credit under the Amended Credit Agreement.

In 2005, we entered into a financing arrangement with Red Mortgage Capital, Inc. to fund our Freddie Mac loan closings. Pursuant to this arrangement, Red Mortgage Capital funds multifamily Freddie Mac loan closings on a transaction-by-transaction basis, with each loan being separately collateralized by a loan and mortgage on a multifamily property that is ultimately purchased by Freddie Mac. On October 24, 2008, PNC Financial Services Group, Inc., announced its intention to acquire National City Corporation, which is the parent company of Red Mortgage Capital, and to participate in the TARP. As of this time we are unable to determine what impact, if any, this

transaction may have on the Company's ability to continue obtain financing from Red Mortgage Capital to support our Freddie Mac business.

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In October 2007, as a result of increases in the volume of the Freddie Mac loans that HFF LP originated as part of its participation in Freddie Mac's Program Plus Seller Servicer program and recently imposed borrowing limits under the financing arrangement with Red Capital of \$150.0 million, we began pursuing alternative financing arrangements to potentially supplement or replace our existing financing arrangement with Red Mortgage Capital. On October 30, 2007, we entered into an amendment to the Amended Credit Agreement to clarify that the \$40.0 million line of credit under the Amended Credit Agreement is available to us for purposes of originating such Freddie Mac loans. We did not borrow under the Amended Credit Agreement in connection with funding the Freddie Mac mortgage loans that we originated or otherwise during the nine months ended September 30, 2008. In addition, in November 2007, we obtained a \$50.0 million financing arrangement from The Huntington National Bank to supplement our Red Mortgage Capital financing arrangement. As of September 30, 2008, we had outstanding borrowings of \$100.3 million under the Red Mortgage Capital/Huntington National Bank arrangement and a corresponding amount of mortgage notes receivable. We believe that our current financing arrangements with Red Mortgage Capital and The Huntington Bank and our lines of credit under the Amended Credit Agreement are sufficient to meet our current needs in connection with our participation in Freddie Mac's Program Plus Seller Servicer program. In the event we are not able to secure financing for our Freddie Mac loan closings, however, we will cease originating such Freddie Mac loans until we have available financing.

We regularly monitor our liquidity position, including cash levels, credit lines, interest and payments on debt, capital expenditures and matters relating to liquidity and to compliance with regulatory net capital requirements. We maintain a line of credit under the Amended Credit Agreement in excess of anticipated liquidity requirements. As of September 30, 2008, based on our Availability, as defined under the Amended Credit Agreement as three times the difference of Consolidated EBITDA, as defined therein, and Consolidated Fixed Charges, as defined therein, we have \$30.0 million of the \$40.0 million in undrawn line of credit available to us under this facility. This facility provides us with the ability to meet short-term cash flow needs resulting from our various business activities. If this facility proves to be insufficient or unavailable to us, we would seek additional financing in the credit or capital markets, although we may be unsuccessful in obtaining such additional financing on acceptable terms or at all especially in light of the issues in the global and domestic capital markets.

**Certain Information Concerning Off-Balance Sheet Arrangements**

We do not currently invest in any off-balance sheet vehicles that provide liquidity, capital resources, market or credit risk support, or engage in any leasing activities that expose us to any liability that is not reflected in our consolidated financial statements.

**Seasonality**

Our capital markets services revenue is typically seasonal, which can affect an investor's ability to compare our financial condition and results of operation on a quarter-by-quarter basis. Historically, this seasonality has caused our revenue, operating income, net income and cash flows from operating activities to be lower in the first six months of the year and higher in the second half of the year. The typical concentration of earnings and cash flows in the last six months of the year is due to an industry-wide focus of clients to complete transactions towards the end of the calendar year. As this typical seasonality is coupled with the current unprecedented disruptions in the global and domestic capital markets and the liquidity issues facing all capital markets, especially the U.S. commercial real estate markets, there is a risk that future historical comparisons will be even more difficult to gauge.

**Effect of Inflation and/or Deflation**

Inflation and/or deflation, especially inflation, could significantly affect our compensation costs, particularly those not directly tied to our transaction professionals' compensation, due to factors such as increased costs of capital. The rise of inflation could also significantly and adversely affect certain expenses, such as debt service costs, information technology and occupancy costs. To the extent that inflation results in rising interest rates and deflation causes significant negative valuation issues and/or either other effects upon the commercial real estate markets in which we operate and, to a lesser extent, the securities markets, it may affect our financial position and results of operations by reducing the demand for commercial real estate and related services which could have a material adverse effect on our financial condition. See Part II Other Information Item 1A Risk Factors.



**Table of Contents****Critical Accounting Policies; Use of Estimates**

We prepare our financial statements in accordance with U.S. generally accepted accounting principles. In applying many of these accounting principles, we need to make assumptions, estimates and/or judgments that affect the reported amounts of assets, liabilities, revenues and expenses in our consolidated financial statements. We base our estimates and judgments on historical experience and other assumptions that we believe are reasonable under the circumstances. These assumptions, estimates and/or judgments, however, are often subjective and they and our actual results may change negatively based on changing circumstances or changes in our analyses. If actual amounts are ultimately different from our estimates, the revisions are included in our results of operations for the period in which the actual amounts become known. We believe the following critical accounting policies could potentially produce materially different results if we were to change underlying assumptions, estimates and/or judgments. See the notes to our consolidated financial statements for a summary of our significant accounting policies.

*Goodwill.* In accordance with Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets*, we evaluate goodwill for potential impairment annually or more frequently if circumstances indicate impairment may have occurred. In this process, we make estimates and assumptions in order to determine the fair value of the Company. In determining the fair value of the Company for purposes of evaluating goodwill for impairment, we utilize an enterprise market capitalization approach. In applying this approach, we use the closing stock price of our Class A common stock as of the measurement date multiplied by the sum of current outstanding shares plus the exchangeable shares as of the measurement date. As of October 31, 2008, management's analysis indicates that an approximate 30% decline in the Company's stock price may result in the recorded goodwill being impaired and would require management to measure the amount of the impairment charge. Goodwill is considered impaired if the recorded book value of goodwill exceeds the implied fair value of goodwill as determined under this valuation technique. We use our best judgment and information available to us at the time to perform this review. Because our assumptions and estimates are used in projecting future earnings as part of the valuation, actual results could differ.

*Intangible Assets.* Our intangible assets primarily include mortgage servicing rights under agreements with third party lenders. Servicing rights are recorded at the lower of cost or market. Mortgage servicing rights do not trade in an active, open market with readily available observable prices. Since there is no ready market value for the mortgage servicing rights, such as quoted market prices or prices based on sales or purchases of similar assets, the Company determines the fair value of the mortgage servicing rights by estimating the present value of future cash flows associated with the servicing the loans. Management makes certain assumptions and judgments in estimating the fair value of servicing rights. The estimate is based on a number of assumptions, including the benefits of servicing (contractual servicing fees and interest on escrow and float balances), the cost of servicing, prepayment rates (including risk of default), an inflation rate, the expected life of the cash flows and the discount rate. The cost of servicing and discount rates are the most sensitive factors affecting the estimated fair value of the servicing rights. Management estimates a market participant's cost of servicing by analyzing the limited market activity and considering the Company's own internal servicing costs. Management estimates the discount rate by considering the vari