BOK FINANCIAL CORP ET AL
Form 5
February 15, 2006

FORM 5

OMB APPROVAL

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Check this box if no longer subject to Section 16. Form 4 or Form 5 obligations may continue. *See* Instruction 1(b).
Form 3 Holdings Reported
Form 4 Transactions Reported

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

ANNUAL STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

1. Name and Address of Reporting Person *
HOLLOMAN HOWARD J

(Last) (First) (Middle)

C/O FREDERIC DORWART,Â 124 E FOURTH STREET

(Street)

TULSA,Â OKÂ 74103

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
BOK FINANCIAL CORP ET AL [BOKF]

3. Statement for Issuer's Fiscal Year Ended (Month/Day/Year)
12/31/2005

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

_____ Director _____ 10% Owner
__X__ Officer (give title below) _____ Other (specify below)
Manager - Trust Division

6. Individual or Joint/Group Reporting

(check applicable line)

_X_ Form Filed by One Reporting Person
___ Form Filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1.Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)	4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned at end of Issuer's Fiscal Year (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
				Amount	(A) or (D)	Price			
Common Stock	12/31/2005	Â	J (1)	164	A	$ (1)	55,521 (2)	D	Â
Common Stock	Â	Â	Â	Â	Â	Â	18,524	I	H. James Holloman and Rebecca W. Holloman

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

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SEC 2270 (9-02)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 3)	2. Conversion or Exercise Price of Derivative Security	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any (Month/Day/Year)	4. Transaction Code (Instr. 8)	5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)		6. Date Exercisable and Expiration Date (Month/Day/Year)		7. Title and Amount of Underlying Securities (Instr. 3 and 4)		8. Pric Deriva Securit (Instr.
					(A)	(D)	Date Exercisable	Expiration Date	Title	Amount or Number of Shares	
Stock Options	Â	Â	Â	Â	Â	Â	Â (4)	Â (5)	Common Stock	46,592 (6)	Â

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
HOLLOMAN HOWARD J C/O FREDERIC DORWART 124 E FOURTH STREET TULSA,Â OKÂ 74103	Â	Â	Â Manager - Trust Division	Â

Signatures

Frederic Dorwart	02/15/2006
**Signature of Reporting Person	Date

Explanation of Responses:

* If the form is filed by more than one reporting person, see Instruction 4(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

(1) Related to BOK Thrift Plan for which employees own investment units which hold BOKF common stock.

(2) These shares represent 50,672 direct shares and 4,849 shares related to the BOK Thrift Plan.

(3) The exercise price varies depending on the grant date.

(4) For options granted in any one year, one-seventh of the options of such grant vest and become exercisable on the grant date of the anniversary each year commencing on the first anniversary after the grant.

(5) Options expire 3 years after vesting.

(6) Mr. Holloman owns the following exercisable stock options: 1996 - 2353 shares 1997 - 4920 shares 1998 - 7453 shares 1999 - 7235 shares 2000 - 7235 shares 2001 - 6556 shares 2003 - 4092 shares (1/3/03 grant date) 2003 - 2484 shares (12/2/03 grant date) 2003 - 2412 shares (12/23/03 grant date) 2004 - 1852 shares

Note: File three copies of this Form, one of which must be manually signed. If space provided is insufficient, *see* Instruction 6 for procedure.
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58,078

461,710

154,344

Non-Interest Expense

Compensation and benefits
65,402

53,719

131,390

109,459

Commissions
17,838

7,437

33,305

15,005

Occupancy and equipment
18,706

16,969

35,656

33,587

Asset resolution
20,851

23,282

57,621

61,391

Federal insurance premiums
12,104

10,789

24,428

19,515

Other taxes
370

667

1,327

1,533

Warrant (income) expense
(551
)

(1,998
)

1,998

(2,825
)
General and administrative
34,777

20,057

72,518

40,488

Total non-interest expense
169,497

130,922

358,243

278,153

Income (loss) before federal income taxes
87,887

(69,904
)

80,577

(96,605
)
Provision for federal income taxes
500

264

500

528

Net Income (Loss)
87,387

(70,168
)

80,077

(97,133
)
Preferred stock dividend/accretion (1)
(1,417
)

(4,720
)

(2,824
)

(9,429
)
Net income (loss) applicable to common stock
$
85,970

$
(74,888
)

$
77,253

$
(106,562
)
Income (loss) per share

Basic
$
0.15

$
(0.14
)

$
0.13

$
(0.19
)
Diluted
$
0.15

$
(0.14
)

$
0.13

$
(0.19
)

(1) The preferred stock dividend/accretion for the three and six months ended June 30, 2012, respectively, represents only the accretion. On January 27, 2012, the Company elected to defer payment of dividends and interest on the preferred stock.

The accompanying notes are an integral part of these Consolidated Financial Statements.

Flagstar Bancorp, Inc.
Consolidated Statements of Comprehensive Income (Loss)
(In thousands)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2012	2011	2012	2011
Net income (loss)	$87,387	$(70,168)	$80,077	$(97,133)
Other comprehensive income (loss), before tax:				
Securities available-for-sale:				
Change in net unrealized loss on sale of securities available-for-sale	1,110	(6,180)	14,231	225
Reclassification of gain on sale of securities available-for-sale	(20)	—	(330)	—
	1,017	15,584	2,192	15,584

Additions for the amount related to the credit loss for which an OTTI impairment was not previously recognized				
Total securities available-for-sale	2,107	9,404	16,093	15,809
Comprehensive income (loss)	$89,494	$(60,764)	$96,170	$(81,324)

The accompanying notes are an integral part of these Consolidated Financial Statements.

Flagstar Bancorp, Inc.
Consolidated Statements of Stockholders' Equity
(In thousands)

	Preferred Stock	Common Stock	Additional Paid in Capital	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total Stockholders' Equity
Balance at December 31, 2010 (Unaudited)	$249,196	$5,533	$1,461,373	$ (16,165)	$(440,274)	$1,259,663
Net loss	—	—	—	—	(97,133)	(97,133)
Total other comprehensive income	—	—	—	15,809	—	15,809
Restricted stock issued	—	2	(2)	—	—	—
Dividends on preferred stock	—	—	—	—	(6,666)	(6,666)
Accretion of preferred stock	2,763	—	—	—	(2,763)	—
Stock-based compensation	—	7	2,760	—	—	2,767
Balance at June 30, 2011	$251,959	$5,542	$1,464,131	$ (356)	$(546,836)	$1,174,440
Balance at December 31, 2011 (Unaudited)	$254,732	$5,558	$1,466,461	$ (7,819)	$(639,216)	$1,079,716
Net income	—	—	—	—	80,077	80,077
Total other comprehensive income	—	—	—	16,093	—	16,093
Restricted stock issued	—	6	(6)	—	—	—
Accretion of preferred stock (1)	2,824	—	—	—	(2,824)	—
Stock-based compensation	—	13	2,450	—	—	2,463
Balance at June 30, 2012	$257,556	$5,577	$1,468,905	$ 8,274	$(561,963)	$1,178,349

(1) The preferred stock dividend/accretion during the six months ended June 30, 2012 represents only the accretion. On January 27, 2012, the Company elected to defer payment of dividends and interest on the preferred stock.

The accompanying notes are an integral part of these Consolidated Financial Statements.

Flagstar Bancorp, Inc.
Consolidated Statements of Cash Flows
(In thousands)

	For the Six Months Ended June 30,	
	2012	2011
	(Unaudited)	
Operating Activities		
Net income (loss)	$80,077	$(97,133)
Reconciliation of net income (loss) to net cash used in operating activities		
Provision for loan losses	173,101	76,693
Depreciation and amortization	9,522	7,166
Loss on fair value of residential first mortgage servicing rights	91,583	16,596

Stock-based compensation expense	2,463	2,767
Net (gain) loss on the sale of assets	(2,480)	585
Net gain on loan sales	(417,518)	(90,012)
Net loss on sales of mortgage servicing rights	3,299	2,493
Net gain on securities classified as available-for-sale	(330)	—
Other than temporary impairment losses on securities classified as available-for-sale	2,192	15,584
Net loss (gain) on trading securities	2,260	(28)
Net loss on transferor interest	1,653	4,640
Proceeds from sales of loans held-for-sale	24,729,954	10,456,988
Origination and repurchase of mortgage loans held-for-sale, net of principal repayments	(24,941,423)	(9,820,042)
Increase in repurchase of mortgage loans with government guarantees, net of claims received	(99,843)	(36,839)
Purchase of trading securities	—	(131,754)
Decrease (increase) in accrued interest receivable	1,215	(7,634)
Proceeds from sales of trading securities	141,220	—
Decrease in other assets	33,084	85,684
Increase (decrease) in accrued interest payable	3,548	(2,030)
(Decrease) increase liability for checks issued	(3,100)	2,850
Decrease in payable for mortgage repurchase option	(33,673)	(7,862)
Increase in representation and warranty reserve	41,000	—
Increase (decrease) in other liabilities	26,980	(6,406)
Net cash (used) provided in operating activities	(155,216)	472,306
Investing Activities		
Proceeds from the sale of investment securities available-for-sale	39,881	—
Net repayment (purchase) of investment securities available-for-sale	30,457	(75,673)
Net proceeds from sales of loans held-for-investment	(268,919)	(20,366)
Origination of portfolio loans, net of principal repayments	234,233	191,947
Proceeds from the disposition of repossessed assets	59,259	63,797
Redemption of Federal Home Loan Bank Stock	—	35,453
Acquisitions of premises and equipment, net of proceeds	(14,534)	(19,457)
Proceeds from the sale of mortgage servicing rights	16,394	44,520
Net cash provided by investing activities	96,771	220,221
Financing Activities		
Net increase (decrease) in deposit accounts	1,232,859	(593,072)
Net decrease in Federal Home Loan Bank advances	(553,000)	(318,512)
Net (disbursement) receipt of payments of loans serviced for others	(103,537)	10,726
Net receipt of escrow payments	21,454	19,346
Dividends paid to preferred stockholders	—	(6,666)
Net cash provided by (used) in financing activities	597,776	(888,178)
Net increase in cash and cash equivalents	539,331	(195,651)
Beginning cash and cash equivalents	731,058	953,534
Ending cash and cash equivalents	$1,270,389	$757,883
Loans held-for-investment transferred to repossessed assets	$250,348	$100,298
Total interest payments made on deposits and other borrowings	$92,055	$117,374
Federal income taxes paid	$225	$—
Reclassification of mortgage loans originated for portfolio to mortgage loans held-for-sale	$287,396	$32,886
Reclassification of mortgage loans originated held-for-sale then transferred to portfolio loans	$18,477	$12,520
Mortgage servicing rights resulting from sale or securitization of loans	$238,176	$88,954

The accompanying notes are an integral part of these Consolidated Financial Statements.

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Flagstar Bancorp, Inc.
Notes to the Consolidated Financial Statements (Unaudited)
Note 1 – Nature of Business
Flagstar Bancorp, Inc. (“Flagstar” or the “Company”), is the holding company for Flagstar Bank, FSB (the “Bank”), a federally chartered stock savings bank founded in 1987. With $14.4 billion in total assets at June 30, 2012, the Company is the largest insured depository institution headquartered in Michigan and is the largest publicly held savings bank headquartered in the Midwest.
The Company is a full-service financial services company, offering a range of products and services to consumers, businesses, and homeowners. As of June 30, 2012, the Company operated 111 banking centers in Michigan, 30 home loan centers in 13 states, and a total of four commercial banking offices in Massachusetts, Connecticut, and Rhode Island. In the second quarter 2012, two banking centers in Michigan were closed to better align the branch structure with the Company's focus on key market areas and to improve banking center efficiencies. The Company originates loans nationwide and is one of the leading originators of residential first mortgage loans. The Company also offers consumer products including deposit accounts, standard and jumbo home loans, home equity lines of credit, and personal loans, including auto and boat loans. The Company also offers commercial loans and treasury management services throughout Michigan and through its four commercial banking offices in Massachusetts, Rhode Island and Connecticut. Commercial products include deposit and sweep accounts, telephone banking, term loans and lines of credit, lease financing, government banking products and treasury management services such as remote deposit and merchant services.
The Company sells or securitizes most of the mortgage loans that it originates and generally retains the right to service the mortgage loans that it sells. These mortgage-servicing rights (“MSRs”) are occasionally sold by the Company in transactions separate from the sale of the underlying mortgages. The Company may also invest in its loan originations to refine the Company's leverage ability and to receive the interest spread between earning assets and paying liabilities.
The Bank is subject to regulation, examination and supervision by the Office of the Comptroller of the Currency (“OCC”) of the United States Department of the Treasury (“U.S. Treasury”). The Bank is also subject to regulation, examination and supervision by the Federal Deposit Insurance Corporation (“FDIC”) and the Consumer Financial Protection Bureau (the “CFPB”). The Bank's deposits are insured by the FDIC through the Deposit Insurance Fund (“DIF”). The Company is subject to regulation, examination and supervision by the Board of Governors of the Federal Reserve (“Federal Reserve”). The Bank is also a member of the Federal Home Loan Bank (“FHLB”) of Indianapolis.
Branch Sales

During the fourth quarter 2011, the Bank completed the previously announced sale of 27 banking centers in Georgia and 22 banking centers in Indiana to PNC Bank, N.A., part of The PNC Financial Services Group, Inc. ("PNC") and First Financial Bank, N.A. ("First Financial"), respectively. Management believes that the Company's presence in the Georgia and Indiana markets lacked market density and sufficient scale, and believes that these transactions are consistent with the strategic focus on core Midwest banking markets and on deployment of capital towards continuing growth in commercial and consumer banking in those markets, as well as the emerging Northeast market.

In the Georgia sale, PNC purchased the facilities or assumed the leases associated with the banking centers and purchased associated business and retail deposits in the amount of $211.3 million. PNC paid the net carrying value of the acquired real estate and fixed and other personal assets associated with the banking centers.

In the Indiana sale, First Financial paid a consideration of a seven percent premium on the consumer and commercial deposits in the Indiana banking centers. The total amount of such consumer and commercial deposits was $462.0 million for a gain of $22.1 million. First Financial paid net carrying value on real estate and personal assets of the banking centers and assumed the existing leases on 14 of the banking centers.

The Company predominantly originated residential mortgage loans for sale in the secondary market in both the Georgia and Indiana markets. Accordingly, the amount of loans on the balance sheet was immaterial and no loans were transferred in either transaction.

Supervisory Agreements

The Company and the Bank are subject to supervisory agreements with the Federal Reserve and the OCC (each a “Supervisory Agreement” and together the “Supervisory Agreements”), each as a successor regulator to the Office of Thrift Supervision ("OTS"). The Supervisory Agreements will remain in effect until terminated, modified, or suspended in writing by the Federal Reserve and the OCC, as appropriate, and the respective failure to comply with the Supervisory Agreements could result in the initiation of further enforcement action by the Federal Reserve or the OCC, as appropriate, including the imposition of further operating restrictions, and could result in additional enforcement actions against the Company or the Bank. The Company has taken actions which it believes are appropriate to comply with, and intend to maintain compliance with, all of the requirements of the Supervisory Agreements.

Pursuant to the Company's Supervisory Agreement with the Federal Reserve, as successor to the OTS, dated January 27, 2010, the Company submitted a capital plan to the OTS, predecessor in interest to the Federal Reserve. In addition, the Company agreed to request prior non-objection of the Federal Reserve to pay dividends or other capital distributions; purchases, repurchases or redemptions of certain securities; incurrence, issuance, renewal, rolling over or increase of any debt and certain affiliate transactions; and comply with restrictions on the payment of severance and indemnification payments, director and management changes and employment contracts and compensation arrangements applicable to the Bank.

Pursuant to the Bank's Supervisory Agreement, the Bank agreed to take actions to address a number of banking issues identified by the OCC. The Bank has completed each of the actions set forth below in the manner and within the time periods required by the Bank's Supervisory Agreement.

- Submitted and received non-objection to a revised business plan that addressed the requirements of the Bank Supervisory Agreement;
- Implemented a plan to reduce doubtful or substandard assets;
- Revised the Bank’s policies and procedures governing loan administration;
- Revised the Bank’s liquidity risk management program to enhance the continuous identification and monitoring of funding needs and access to funds to meet those needs;
- Remediated issues related to market risk exposure, including the engagement of a qualified and independent third party to perform a model valuation;
- Revised the Bank’s asset concentration policy for mortgage servicing rights to reflect the revised business plan and remediated mortgage servicing rights issues;
- Established a new written consumer compliance program appropriate for the Bank’s size, complexity, product lines and business operations and compliant with applicable law;
- Revised the Bank’s policies, procedures and systems for compliance with flood insurance requirements and reviewed all loans originated after September 30, 2008 for compliance with flood insurance requirements; and
- Restricted quarterly asset growth to an amount not to exceed net interest credited on deposit liabilities until the revised business plan received non-objection (such plan received non-objection from the OTS concurrent with the execution of the Bank's Supervisory Agreement).

In addition, the Bank agreed to operate within the parameters of the revised business plan, request OCC approval of dividends or other capital distributions, not make certain severance or indemnification payments, notify the OCC of changes in directors or senior executive officers, provide notice of new, renewed, extended or revised contractual arrangements relating to compensation or benefits for any senior executive officer or directors, receive consent to increase salaries, bonuses or director’s fees for directors or senior executive officers, and receive OCC non-objection to certain third party arrangements.

The foregoing summary of the Supervisory Agreements does not purport to be a complete description of all of the terms of the Supervisory Agreements, and is qualified in its entirety by reference to copies of the Supervisory

Agreements filed with the Securities and Exchange Commission (the "SEC") as an exhibit to our Current Report on Form 8-K filed on January 28, 2010.

The Company and the Bank addressed the banking issues identified by the OCC in the manner and within the time periods required for compliance with the Supervisory Agreements, and they do not believe that continued compliance with the Supervisory Agreements will have any material adverse impact on their future financial results. However, the Company and the Bank believe that the enhanced asset and risk management should, over time, improve the Bank's overall credit quality and risk profile through enhanced monitoring of credit quality trends, overall reduction in the level of doubtful and substandard assets, and enhanced compliance activities.

Troubled Asset Relief Program

On October 3, 2008, the Emergency Economic Stabilization Act of 2008 (initially introduced as the Troubled Asset Relief Program (“TARP”)) was enacted, and the U.S. Treasury injected capital into U.S. financial institutions. On January 30, 2009, the Company entered into a letter agreement including the securities purchase agreement with the U.S. Treasury pursuant to which, among other things, the Company sold to the U.S. Treasury preferred stock and warrants. Furthermore, as long as the preferred stock issued to the U.S. Treasury is outstanding, dividend payments and repurchases or redemptions relating to certain equity securities, including the Company's common stock, par value $0.01 per share (the “Common Stock”), are prohibited until all accrued and unpaid dividends are paid on such preferred stock, subject to certain limited exceptions. The preferred stock accrues cumulative dividends quarterly at a rate of 5 percent per annum until January 30, 2014, and 9 percent per annum thereafter.

Note 2 – Basis of Presentation and Accounting Policies

The unaudited consolidated financial statements of the Company have been prepared in accordance with generally accepted accounting principles for interim information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X as promulgated by the SEC. Accordingly, they do not include all the information and footnotes required by accounting principles generally accepted in the United States of America (“U.S. GAAP”) for complete financial statements. The accompanying interim financial statements are unaudited; however, in the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The results of operations for the three and six months ended June 30, 2012, are not necessarily indicative of the results that may be expected for the year ending December 31, 2012. In addition, certain prior period amounts have been reclassified to conform to the current period presentation. For further information, reference should be made to the consolidated financial statements and footnotes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2011, which are available on the Company’s Investor Relations web page, at www.flagstar.com, and on the SEC website, at www.sec.gov.

Recently Adopted Accounting Standards

On January 1, 2012, the Company adopted the update to Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) Topic 220, “Comprehensive Income” and applied the provisions retrospectively. Under the amended guidance, an entity had the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income (“OCI”) either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, the entity is required to present on the face of the financial statements reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statement(s) where the components of net income and the components of other comprehensive income are presented. The adoption of the guidance did not have a material effect on the Company's Consolidated Financial Statements or the Notes thereto. For further information concerning comprehensive income, refer to Consolidated Statements of Comprehensive Income and Note 15 - Stockholders'

Equity.

On January 1, 2012, the Company prospectively adopted the update to FASB ASC Topic 820, “Fair Value Measurement.” The amended guidance did not modify the requirements for when fair value measurements apply, rather it generally represents clarifications on how to measure and disclose fair value under Topic 820, Fair Value Measurement. The guidance is intended to improve the comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with U.S. GAAP and International Financial Reporting Standards (“IFRS”), by ensuring that fair value has the same meaning in U.S. GAAP and IFRS and respective disclosure requirements are the same except for inconsequential differences in wording and style. The adoption of the guidance did not have a material effect on the Company's Consolidated Financial Statements or the Notes thereto. For further information concerning fair value, refer to Note 3 - Fair Value Accounting.

On January 1, 2012, the Company adopted FASB ASC Topic 860, “Transfers and Servicing (Topic 860) - Reconsideration of Effective Control for Repurchase Agreements.” Under the amended guidance, a transferor maintains effective control over transferred financial assets if there is an agreement that both entitles and obligates the transferor to repurchase the financial assets before maturity. In addition, the following requirements must be met: (i) the financial asset to be repurchased or redeemed are the same or substantially the same as those transferred, (ii) the agreement is to repurchase or redeem the transferred financial asset before maturity at a fixed or determinable price, and (iii) the agreement is entered into contemporaneously with, or in contemplation of the transfer. The adoption of the guidance did not have a material effect on the Company's Consolidated Financial Statements or the Notes thereto.

On July 1, 2011, the Company adopted the update to FASB ASC Topic 310, “Receivables - A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring” and applied the provisions retrospectively to January 1, 2011. The troubled debt restructuring (“TDR”) guidance clarifies whether loan modifications constitute TDRs, include factors and examples for creditors to consider in evaluating whether a restructuring results in a delay in payment that is insignificant, prohibit creditors from using the borrower's effective rate test to evaluate whether the restructuring constitutes as a TDR and a concession has been granted to the borrower, and clarifies the guidance for creditors to use in determining whether a borrower is experiencing financial difficulties. The adoption of the guidance did not have a material effect on the Company's Consolidated Financial Statements or the Notes thereto. For further information concerning TDRs, refer to Note 7 - Loans Held-for-Investment.

Recent Accounting Pronouncements

In December 2011, the FASB issued Accounting Standards Update (“ASU”) No. 2011-10, “Property, Plant, and Equipment (Topic 360): Derecognition of in Substance Real Estate - a Scope Clarification.” The guidance represents the consensus reached in Emerging Issues Task Force Issue No. 10-E, “Derecognition of in Substance Real Estate” and applies to a parent that ceases to have a controlling financial interest in a subsidiary that is in substance real estate as a result of default on the subsidiary's nonrecourse debt. ASU 2011-10 provides that when a parent (reporting entity) ceases to have a controlling financial interest in a subsidiary that is in substance real estate as a result of default on the subsidiary's nonrecourse debt. ASU 2011-10 should be applied on a prospective basis to deconsolidation events occurring after the effective date; with prior periods not adjusted even if the reporting entity has continuing involvement with previously derecognized in substance real estate entities. This guidance is effective prospective for annual and interim periods beginning on or after June 15, 2012. Early adoption is permitted. The adoption of the guidance is not expected to have a material impact on the Company's Consolidated Financial Statements or the Notes thereto.

In December 2011, the FASB issued ASU No. 2011-11, “Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities.” The guidance requires an entity to disclose information about offsetting and related arrangements to enable users of financial statements to understand the effect of those arrangements on its financial position. The FASB issued common disclosure requirements related to offsetting arrangements to allow investors to better compare financial statements prepared in accordance with IFRS or U.S. GAAP. The objective of this guidance is to facilitate comparison between those entities that prepare their financial statements on the basis of U.S. GAAP and

those entities that prepare their financial statements on the basis of IFRS. This guidance is effective retrospectively, for annual and interim periods, beginning on or after January 1, 2013. The adoption of the guidance is not expected to have a material impact on the Company's Consolidated Financial Statements or the Notes thereto.

Note 3 – Fair Value Accounting

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability, in either case through an orderly transaction between market participants at the measurement date. The Company utilizes fair value measurements to record certain assets and liabilities at fair value and to determine fair value disclosures. The determination of fair values of financial instruments often requires the use of estimates. In cases where quoted market values in an active market are not available, the Company uses present value techniques and other valuation methods to estimate the fair values of its financial instruments. These valuation models rely on market-based parameters when available, such as interest rate yield curves, credit spreads or unobservable inputs. Unobservable inputs may be based on management's judgment, assumptions and estimates related to credit quality, asset growth, the Company's future earnings, interest rates and other relevant inputs. These valuation methods require considerable judgment and the resulting estimates of fair value can be significantly affected by the assumptions made and methods used.

Valuation Hierarchy

U.S. GAAP establishes a three level valuation hierarchy for disclosure of fair value measurements that is based on the transparency of the inputs used in the valuation process. The three levels of the hierarchy, highest ranking to lowest, are as follow:

Level 1 -Quoted prices (unadjusted) for identical assets or liabilities in active markets in which the Company can participate as of the measurement date;
Level 2 -Quoted prices for similar instruments in active markets, and other inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument; and
Level 3 -Unobservable inputs that reflect the Company's own assumptions about the assumptions that market participants would use in pricing and asset or liability.

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A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input within the valuation hierarchy that is significant to the overall fair value measurement. Transfers between levels of the fair value hierarchy are recognized at the end of the reporting period.

The following is a description of the valuation methodologies used by the Company for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy.

Assets

Securities classified as trading. These securities are comprised of U.S. government sponsored agency mortgage-backed securities, U.S. Treasury bonds and non investment grade residual securities that arose from private label securitizations of the Company. The U.S. government sponsored agency mortgage-backed securities and U.S. Treasury bonds trade in an active, open market with readily observable prices and are therefore classified within the Level 1 valuation hierarchy. The non investment grade residual securities do not trade in an active, open market with readily observable prices and are therefore classified within the Level 3 valuation hierarchy. Under Level 3, the fair value of residual securities is determined by discounting estimated net future cash flows using expected prepayment rates and discount rates that approximate current market rates. Estimated net future cash flows include assumptions related to expected credit losses on these securities. The Company maintains a model that evaluates the default rate and severity of loss on the residual securities collateral, considering such factors as loss experience, delinquencies, loan-to-value ratios, borrower credit scores and property type. At June 30, 2012 and December 31, 2011, the Company had no Level 3 securities classified as trading. See Note 9 - Private-Label Securitization Activity, for the key assumptions used in the residual interest valuation process.

Securities classified as available-for-sale. These securities are comprised of U.S. government sponsored agency mortgage-backed securities and CMOs. Where quoted prices for securities are available in an active market, those securities are classified within Level 1 of the valuation hierarchy. Where quoted market prices are not available, then fair values are estimated using pricing models, quoted prices of securities with similar characteristics, or discounted cash flows and those securities are classified within Level 2 of the valuation hierarchy. Where markets are illiquid and fair values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement, those securities are classified within Level 3 of the valuation hierarchy. Due to illiquidity in the markets, the Company determined the fair value of the FSTAR 2006-1 securitization trust using a discounted estimated net future cash flow model and therefore classified it within the Level 3 valuation hierarchy as the model utilizes significant inputs which are unobservable.

Loans held-for-sale. The Company generally estimates the fair value of mortgage loans held-for-sale based on quoted market prices for securities backed by similar types of loans. Where quoted market prices were available, such market prices were utilized as estimates for fair values. Otherwise, the fair value of loans was computed by discounting cash flows using observable inputs inclusive of interest rates, prepayment speeds and loss assumptions for similar collateral. These measurements are classified as Level 2.

Loans held-for-investment. Loans held-for-investment are generally recorded at amortized cost. The Company does not record these loans at fair value on a recurring basis. However, from time to time a loan is considered impaired when it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement. Once a loan is identified as impaired, the fair value of the impaired loan is estimated using one of several methods, including collateral value, market value of similar debt, or discounted cash flows. The fair value of the underlying collateral is determined, where possible, using market prices derived from appraisals or broker price opinions which are considered to be Level 3. Fair value may also be measured using the present value of expected cash flows discounted at the loan's effective interest rate. The Company records the impaired loan as a non-recurring Level 3 valuation.

Loans held-for-investment on a recurring basis are loans that were previously recorded as loans held-for-sale but subsequently transferred to the held-for-investment category. As the Company selected the fair value option for the held-for-sale loans, they continue to be reported at fair value and measured consistent with the Level 2 methodology for loans held-for-sale.

Included in loans held-for-investment is the transferor's interest on the home equity line of credit (“HELOC”) securitizations. The Company fair value of the transferor's interest is based on the claims due to the note insurer and continuing credit losses on the loans underlying the securitizations, which are considered to be Level 3. See Note 9 - Private-Label Securitization Activity, for the key assumptions used in the transferor's interest valuation process.

Repossessed assets. Loans on which the underlying collateral has been repossessed are adjusted to fair value less costs to sell upon transfer to repossessed assets. Subsequently, repossessed assets are carried at the lower of carrying value or fair value, less anticipated marketing and selling costs. Fair value is generally based upon third-party appraisals or internal estimates and considered a Level 3 classification.

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Residential MSRs. The current market for residential MSRs is not sufficiently liquid to provide participants with quoted market prices. Therefore, the Company uses an option adjusted spread valuation approach to determine the fair value of residential MSRs. This approach consists of projecting servicing cash flows under multiple interest rate scenarios and discounting these cash flows using risk adjusted discount rates. The key assumptions used in the valuation of residential MSRs include mortgage prepayment speeds and discount rates. Management obtains third party valuations of the residential MSR portfolio on a quarterly basis from independent valuation experts to assess the reasonableness of the fair value calculated by its internal valuation model. Due to the nature of the valuation inputs, residential MSRs are classified within Level 3 of the valuation hierarchy. See Note 10 - Mortgage Servicing Rights, for the key assumptions used in the residential MSR valuation process.

Derivative financial instruments. Certain classes of derivative contracts are listed on an exchange and are actively traded, and they are therefore classified within Level 1 of the valuation hierarchy. These include U.S. Treasury futures and U.S. Treasury options. The Company's forward loan sale commitments and interest rate swaps are valued based on quoted prices for similar assets in an active market with inputs that are observable and are classified within Level 2 of the valuation hierarchy. Rate lock commitments are valued using internal models with significant unobservable market parameters and therefore are classified within Level 3 of the valuation hierarchy. The Company assessed the significance of the impact of the credit valuation adjustments on the overall valuation of its derivative positions and determined that the credit valuation adjustments were not significant to the overall valuation of its derivatives. The derivatives are reported in either “other assets” or “other liabilities” on the Consolidated Statements of Financial Condition.

Equity-linked transaction and option commitment. The equity-linked transaction and option commitment serves as a hedge (off-set) to the market risk incurred with the Company's participation of equity-linked certificates of deposit. The option represents the premium over the total notional amount of the hedge. The valuations are based on counter-party risk systems measuring the present value of each instrument and its future payments. The risk systems take into consideration economic terms of the trade and current market levels including spot rates, and underlying volatility and correlation among other factors.
Liabilities

Warrants. Warrant liabilities are valued using a binomial lattice model and are classified within Level 2 of the valuation hierarchy. Significant observable inputs include expected volatility, a risk free rate and an expected life. Warrant liabilities are reported in “other liabilities” on the Consolidated Statements of Financial Condition.

Litigation settlement. On February 24, 2012, the Company announced that the Bank had entered into an agreement (the “DOJ Agreement”) with the U.S. Department of Justice ("DOJ") relating to certain underwriting practices associated with loans insured by the Federal Housing Administration ("FHA") of the Department of Housing and Urban Development ("HUD"). The Bank and the DOJ entered into the DOJ Agreement pursuant to which the Bank agreed to comply with all applicable HUD and FHA rules related to the continued participation in the direct endorsement lender program, make an initial payment of $15.0 million within 30 business days of the effective date of the DOJ Agreement (paid on April 3, 2012), make payments of approximately $118.0 million contingent upon the occurrence of certain future events (as further described below) (the "Additional Payments"), and complete a monitoring period by an independent third party chosen by the Bank and approved by HUD.

Based on analysis of the DOJ Agreement, the Company recorded a liability of $33.3 million at December 31, 2011. During the six months ended June 30, 2012, the Company recorded an increase to the liability of $0.8 million, principally representing the recognition of the periodic effect of discounting. During the second quarter 2012, a payment of $15.0 million was paid bringing the liability at June 30, 2012 to $19.1 million, which represents the estimated fair value of the $118.0 million Additional Payments. Future changes in the fair value of the Additional

Payments could affect in future earnings each quarters.

The Company has elected the fair value option to account for the liability representing the obligation to make Additional Payments under the DOJ Agreement. The signed settlement contract with the DOJ establishes a legally enforceable contract with a stipulated payment plan that meets the definition of a financial liability. The Company made the fair value election as of December 31, 2011, the date the Company first recognized the financial instrument in its financial statements.

The specific terms of the payment structure are as follow:

- The Company generates positive income for a sustained period, such that part or all of the Deferred Tax Asset ("DTA"), which has been offset by a valuation allowance ("DTA Valuation Allowance"), is likely to be realized, as evidenced by the reversal of the DTA Valuation Allowance in accordance with U.S. GAAP;

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- The Company is able to include capital derived from the reversal of the DTA Valuation Allowance in the Bank's Tier 1 capital, which is the lesser of 10 percent of Tier 1 capital or the amount of the DTA that the Company expects to recover within one year based on financial projections;

- The Company's obligation to repay the $266.7 million in preferred stock held by the U.S. Treasury under the TARP Capital Purchase Program has been either extinguished or excluded from Tier 1 capital for purposes of calculating the Tier 1 capital ratio as described in the paragraph below;

- Upon the occurrence of each of the future events described above, and provided doing so would not violate any banking regulatory requirement or the OCC does not otherwise object, the Company will begin making Additional Payments provided that (i) each annual payment would be equal to the lesser of $25 million or the portion of the Additional Payments that remains outstanding after deducting prior payments; and (ii) no obligation arises until the Company's call report as filed with the OCC, including any amendments thereto, for the period ending at least six months prior to the making of such Additional Payments, reflects a minimum Tier 1 capital ratio of 11 percent (or higher if required by regulators), after excluding any unextinguished portion of the preferred stock held by U.S. Treasury under the TARP Capital Purchase Program; and

- In no event will the Company be required to make an Additional Payment if doing so would violate any material banking regulatory requirement or the OCC (or any successor regulator under the safety and soundness program) objects in writing to the making of an Additional Payment.

The fair value of the DOJ Agreement is based on a discounted cash flow valuation model that incorporates the Company's current estimate of the most likely timing and amount of the cash flows necessary to satisfy the obligation. These cash flow estimates are reflective of the Company's detailed financial and operating projections for the next three years, as well as more general growth earnings and capital assumptions for subsequent periods.

The timing of each of the metrics is dependent on the preceding metric being achieved and actual Bank operating results and forecasted assumptions could materially change the value of the liability. As the Bank's profitability increases, the value of the deferred liability would also increase.

The cash flows are discounted using a 15.6 percent discount rate that is inclusive of the risk free rate based on the expected duration of the liability and an adjustment for nonperformance risk that represents the Company's credit risk. The model assumes 12 quarters of profitability prior to reversing the valuation allowance associated with the deferred tax asset.

The liability is classified within Level 3 of the valuation hierarchy given the projections of earnings and growth rate assumptions are unobservable inputs. The litigation settlement is included in other liabilities on the Consolidated Financial Statements and changes in the fair value of the litigation settlement will be recorded each quarter in general and administrative expense within non-interest expense on the Consolidated Statements of Operations.

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Assets and liabilities measured at fair value on a recurring basis

The following tables present the financial instruments carried at fair value as of June 30, 2012 and December 31, 2011, by caption on the Consolidated Statement of Financial Condition and by the valuation hierarchy (as described above).

	Level 1	Level 2	Level 3	Total Fair Value
June 30, 2012	(Dollars in thousands)			
Securities classified as trading:				
U.S. Treasury bonds	$169,834	$—	$—	$169,834
Securities classified as available-for-sale:				
Non-agency collateralized mortgage obligations	—	204,326	100,306	304,632
U.S. government sponsored agencies	100,133	—	—	100,133
Municipal obligations	—	20,000	—	20,000
Loans held-for-sale:				
Residential first mortgage loans	—	2,195,679	—	2,195,679
Loans held-for-investment:				
Residential first mortgage loans	—	20,231	—	20,231
Transferor's interest	—	—	7,660	7,660
Residential mortgage servicing rights	—	—	638,865	638,865
Equity-linked CD purchase option	436	—	—	436
Derivative assets:				
Agency forwards	6,357	—	—	6,357
Rate lock commitments	—	—	132,388	132,388
U.S. Treasury futures	7,057	—	—	7,057
Interest rate swaps	—	4,938	—	4,938
Total derivative assets	13,414	4,938	132,388	150,740
Total assets at fair value	$283,817	$2,445,174	$879,219	$3,608,210
Derivative liabilities:				
Forward agency and loan sales	$—	$(46,294)	$—	$(46,294)
Interest rate swaps	—	(4,938)	—	(4,938)
Total derivative liabilities	—	(51,232)	—	(51,232)
Warrant liabilities	—	(4,409)	—	(4,409)
Equity-linked CD written option	(436)	—	—	(436)
Litigation settlement	—	—	(19,100)	(19,100)
Total liabilities at fair value	$(436)	$(55,641)	$(19,100)	$(75,177)

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December 31, 2011	Level 1	Level 2	Level 3	Total Fair Value
	(Dollars in thousands)			
Securities classified as trading:				
U.S. Treasury bonds	$313,383	$—	$—	$313,383
Securities classified as available-for-sale:				
Non-agency collateralized mortgage obligations	—	—	365,256	365,256
U.S. government sponsored agencies	116,096	—	—	116,096
Loans held-for-sale:				
Residential first mortgage loans	—	1,629,618	—	1,629,618
Loans held-for-investment:				
Residential first mortgage loans	—	22,651	—	22,651
Residential mortgage servicing rights	—	—	510,475	510,475
Derivative assets:				
U.S. Treasury futures	3,316	—	—	3,316
Rate lock commitments	—	—	70,965	70,965
Agency forwards	9,362	—	—	9,362
Interest rate swaps	—	3,296	—	3,296
Total derivative assets	12,678	3,296	70,965	86,939
Total assets at fair value	$442,157	$1,655,565	$946,696	$3,044,418
Derivative liabilities:				
Forward agency and loan sales	$—	$(42,978)	$—	$(42,978)
Interest rate swaps	—	(3,296)	—	(3,296)
Total derivative liabilities	—	(46,274)	—	(46,274)
Warrant liabilities	—	(2,411)	—	(2,411)
Litigation settlement (1)	—	—	(18,300)	(18,300)
Total liabilities at fair value	$—	$(48,685)	$(18,300)	$(66,985)

(1) Does not include the $15.0 million payment required to be paid within 30 business days after the effective date of the DOJ Agreement, which was paid on April 3, 2012.

A determination to classify a financial instrument within Level 3 of the valuation hierarchy is based upon the significance of the unobservable factors to the overall fair value measurement. However, Level 3 financial instruments typically include, in addition to the unobservable or Level 3 components, observable components (that is, components that are actively quoted and can be validated to external sources). Also, the Company manages the risk associated with the observable components of Level 3 financial instruments using securities and derivative positions that are classified within Level 1 or Level 2 of the valuation hierarchy; these Level 1 and Level 2 risk management instruments are not included below, and therefore the gains and losses in the tables do not reflect the effect of the Company's risk management activities related to such Level 3 instruments. If the market for an instrument becomes more liquid or active and pricing models become available which allow for readily observable inputs, the Company will transfer the instruments from Level 3 to Level 2 valuation hierarchy.

Interest rate swap derivatives were transferred from Level 1 to Level 2 during the fourth quarter 2011 because the derivatives are not actively being traded on a listed exchange. The interest rate swap derivatives are valued based on quoted prices for similar assets in an active market with inputs that are observable and are now classified within Level 2 of the valuation hierarchy.

Non-agency collateralized mortgage obligations were transferred from Level 3 to Level 2 during the six months ended June 30, 2012 due to increased market liquidity and an increase in the number of available pricing models. The

non-agency collateralized mortgage obligations are valued based on pricing provided by external pricing services.

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Transferor's interest were transferred into Level 3 during the six months ended June 30, 2012 due to the assumptions utilized in the valuation of the claims to the note insurer and continuing credit losses on the loans underlying the securitization. Transferor's interest are valued based on pricing of the loans underlying the securitization and are now classified within Level 3 of the valuation hierarchy.

The Company had no transfers of assets or liabilities recorded at fair value for three and six months ended June 30, 2011. The Company reclassified the 2011 nonrecurring hierarchy disclosures for impaired loans and repossessed assets from Level 2 to Level 3 to reflect that the appraised values, broker price opinions or internal estimates contain unobservable inputs. The impact of the transfer did not have a material effect on the Company's Consolidated Financial Statements or the Notes thereto and was limited to disclosure.

Fair value measurements using significant unobservable inputs

The tables below include a roll forward of the Consolidated Statement of Financial Condition amounts for the three and six months ended June 30, 2012 and 2011 (including the change in fair value) for financial instruments classified by the Company within Level 3 of the valuation hierarchy.

		Recorded in Earnings		Recorded in OCI							
For the Three Months Ended June 30, 2012	Balance at Beginning of Period	Total Unrealized Gains / (Losses)	Total Realized Gains / (Losses)	Total Unrealized Gains / (Losses)	Issuances	Purchases	Sales	Settlements	Transfers In (Out)	Balance at End of Period	Changes In Unrealized Held at End of Period (4)
Assets	(Dollars in thousands)										
Securities classified as available-for-sale (1)(2)(3)											
Non-agency collateralized mortgage obligations	$105,034	$—	$—	$1,006	$—	$—	$(5,734)	$—	$—	$100,306	$1,006
Loans held-for-investment											
Transferor's interest	8,985	—	(1,244)	—	—	—	(81)	—	—	7,660	—
Residential mortgage servicing rights	596,830	(55,491)	—	—	—	126,691	—	(29,165)	—	638,865	—
Derivative financial instruments:											
Rate lock commitments	68,248	186,426	—	—	—	215,389	(249,745)	(87,930)	—	132,388	—
Totals	$779,097	$130,935	$(1,244)	$1,006	$—	$342,080	$(255,560)	$(117,095)	$—	$879,219	$1,006
Liabilities											
Litigation settlement	$(19,100)	$—	$—	$—	$—	$—	$—	$—	$—	$(19,100)	$—

For the Three Months Ended June 30, 2011
Securities classified as

available-for-sale: (1)(2)(3)											
Non-agency collateralized mortgage obligations	$444,957	$—	$—	$(5,363)	$—	$—	$(20,829)	$—	$—	$418,765	$10,221
Residential mortgage servicing rights	635,122	(95,976)	—	—	—	38,255	—	—	—	577,401	—
Derivative financial instruments:											
Rate lock commitments	13,780	44,792	—	—	—	48,215	(95,867)	—	—	10,920	—
Totals	$1,093,859	$(51,184)	$—	$(5,363)	$—	$86,470	$(116,696)	$—	$—	$1,007,086	$10,221

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		Recorded in Earnings		Recorded in OCI							
For the Six Months Ended June 30, 2012	Balance at Beginning of Period	Total Unrealized Gains / (Losses)	Total Realized Gains / (Losses)	Total Unrealized Gains / (Losses)	Issuances	Purchases	Sales	Settlements	Transfers In (Out)	Balance at End of Period	Change In Unreal Held a of Peri
Assets	(Dollars in thousands)										
Securities classified as available-for-sale (1)(2)(3)											
Non-agency collateralized mortgage obligations	$365,256	$—	$—	$1,691	$—	$—	$(11,713)	$—	$(254,928)	$100,306	$1,691
Loans held-for-investment											
Transferor's interest	—	—	(1,653)	—	—	—	(281)	—	9,594	7,660	—
Residential mortgage servicing rights	510,475	(35,586)	—	—	—	238,175	(18,202)	(55,997)	—	638,865	—
Derivative financial instruments:											
Rate lock commitments	70,965	234,765	—	—	—	386,537	(408,913)	(150,966)	—	132,388	—
Totals	$946,696	$199,179	$(1,653)	$1,691	$—	$624,712	$(439,109)	$(206,963)	$(245,334)	$879,219	$1,691
Liabilities											
Litigation settlement	$(18,300)	$—	$(800)	$—	$—	$—	$—	$—	$—	$(19,100)	$—
For the Six Months Ended June 30, 2011											
Securities classified as available-for-sale: (1)(2)(3)											
Non-agency collateralized mortgage obligations	$467,488	$—	$2,359	$—	$—	$—	$(51,082)	$—	$—	$418,765	$17,94
Residential mortgage servicing rights	580,299	(91,853)	—	—	—	88,955	—	—	—	577,401	—
Derivative financial instruments:										—	
Rate lock commitments	14,396	38,590	—	—	—	97,059	(139,125)	—	—	10,920	—
Totals	$1,062,183	$(53,263)	$2,359	$—	$—	$186,014	$(190,207)	$—	$—	$1,007,086	$17,94

(1)

Realized gains (losses), including unrealized losses deemed other-than-temporary and related to credit issues, are reported in non-interest income.

(2) U.S. government agency securities classified as available-for-sale are valued predominantly using quoted broker/dealer prices with adjustments to reflect for any assumptions a willing market participant would include in its valuation. Non-agency securities classified as available-for-sale are valued using internal valuation models and pricing information from third parties.

(3) Management had anticipated that the non-agency securities would be classified under Level 2 of the valuation hierarchy. However, due to illiquidity in the markets, the fair value of these securities has been determined using internal models and therefore is classified within Level 3 of the valuation hierarchy and pricing information from third parties.

(4) Changes in the unrealized gains (losses) related to financial instruments held at the end of the period.

The following tables present the quantitative information about recurring Level 3 fair value financial instruments and the fair value measurements as of June 30, 2012.

	Fair Value	Valuation Technique	Unobservable Input	Range (Weighted Average)
June 30, 2012	(Dollars in thousands)			
Assets				
FSTAR 2006-1	$100,306	Discounted cash flows	Discount rate Prepay rate - 12 month historical average CDR rate - 12 month historical average Loss severity	7.2% - 10.8% (9.0%) 8.2% - 12.3% (10.2%) 5.1% - 7.7% (6.4%) 80.0% - 120.0% (100.0%)
Transferor's interest	$7,660	Discounted cash flows	Discount rate Prepay rate - 3 month historical average Cumulative loss rate Loss severity	4.6% - 6.9% (5.7%) 7.2% - 10.8% (9.0%) 11.3% - 17.0% (14.2%) 80.0% - 120.0% (100.0%)
Residential mortgage servicing rights	$638,865	Discounted cash flows	Option adjusted spread Constant prepayment rate Weighted average cost to service per loan	5.1% - 7.7% (6.4%) 15.3% - 22.8% (19.1%) 59.9% - 89.9% (74.9%)
Rate lock commitments	$132,388	Mark-to-Market	Origination pull-through rate	62.1% - 93.1% (77.6%)
Liabilities				
Litigation settlement	$(19,100)	Discounted cash flows	Asset growth rate MSR growth rate Return on assets (ROA) improvement	4.4% - 6.6% (5.5%) 0.9% - 1.4% (1.2%) 0.02% - 0.04% (0.03%)

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The significant unobservable inputs used in the fair value measurement of the FSTAR 2006-1 securitization trust are discount rates, prepayment rates and default rates. While loss severity (in the event of default) is an unobserveable input, the sensitivity of the fair value to this input is zero because of the insurer coverage on the deal. Significant increases (decreases) in the discount rate in isolation would result in a significantly lower (higher) fair value measurement. Increases in both prepay rates and default rates in isolation result in a higher fair value; however, generally a change in the assumption used for the probability of default is accompanied by a directionally opposite change in the assumption used for prepayment rates, which would offset a portion of the fair value change.

The significant unobservable inputs used in the fair value measurement of the transferor's interest are discount rates, prepayment rates, loss rates and loss severity. Significant increases (decreases) in the discount rate in isolation would result in a significantly lower (higher) fair value measurement. Increases in both prepay rates and loss rates in isolation result in a lower fair value; however, generally a change in the assumption used for the loss rate is accompanied by a directionally opposite change in the assumption used for prepayment rates, which would offset a portion of the fair value change. Significant increases (decreases) in the loss severity rate in isolation would result in a significantly lower (higher) fair value measurement.

The significant unobservable inputs used in the fair value measurement of the MSRs are option adjusted spreads, prepayment rates, and cost to service. Significant increases (decreases) in all three assumptions in isolation would result in a significantly lower (higher) fair value measurement.

The significant unobservable input used in the fair value measurement of the rate lock commitments is the pull through rate. The pull through rate is a statistical analysis of the Company's actual rate lock fallout history to determine the sensitivity of the residential mortgage loan pipeline compared to interest rate changes and other deterministic values. New market prices are applied based on updated loan characteristics and new fall out ratios (i.e., the inverse of the pull through rate) are applied accordingly. Significant increases (decreases) in the pull through rate in isolation would result in a significantly higher (lower) fair value measurement. Generally, a change in the assumption utilized for the probability of default is accompanied by a directionally similar change in the assumption utilized for the loss severity and a directionally opposite change in assumption utilized for prepayment rates.

The significant unobservable inputs used in the fair value measurement of the DOJ Agreement are future balance sheet and growth rate assumptions for overall asset growth, MSR growth, and return on assets improvement. The current assumptions are based on management's strategic performance targets beyond the current strategic modeling horizon (2015). The Bank's target asset growth rate post 2015 is based off of growth in the balance sheet post TARP preferred stock repayment. Significant increases (decreases) in the bank's asset growth rate in isolation would result in a significantly lower (higher) fair value measurement. Significant increases (decreases) in the bank's MSR growth rate in isolation would result in a marginally lower (higher) fair value measurement. Significant increases (decreases) in the bank's return on assets improvement in isolation would result in a marginally higher (lower) fair value measurement.

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The Company also has assets that under certain conditions are subject to measurement at fair value on a non-recurring basis. These assets are measured at the lower of cost or market and had a fair value below cost at the end of the period as summarized below.

Assets Measured at Fair Value on a Non-recurring Basis

	Total	Level 3
	(Dollars in thousands)	
June 30, 2012		
Impaired loans held-for-investment: (1)		
Residential first mortgage loans	$140,103	$140,103
Commercial real estate loans	146,135	146,135
Repossessed assets (2)	107,235	107,235
Totals	$393,473	$393,473
December 31, 2011		
Impaired loans held-for-investment: (1)		
Residential first mortgage loans	$210,040	$210,040
Commercial real estate loans	180,306	180,306
Repossessed assets (2)	114,715	114,715
Totals (3)	$505,061	$505,061

(1) The Company recorded $42.1 million and $89.9 million in fair value losses on impaired loans (included in provision for loan losses on the Consolidated Statements of Operations) during the three and six months ended June 30, 2012, respectively, compared to $15.2 million and $29.8 million in fair value losses on impaired loans during the three and six months ended June 30, 2011, respectively.

(2) The Company recorded $4.0 million and $9.8 million in losses related to write-downs of repossessed assets based on the estimated fair value of the specific assets, and recognized net gains of $3.2 million and $2.5 million on sales of repossessed assets during the three and six months ended June 30, 2012, respectively, compared to $5.7 million and $18.9 million in losses related to write-downs of repossessed assets based on the estimated fair value of the specific assets, and recognized net gains of $0.8 million and $0.7 million on sales of repossessed assets during the three and six months ended June 30, 2011, respectively.

(3) As of December 31, 2011, the Company reclassified impaired loans and repossessed assets from Level 2 to Level 3 to reflect that many of the appraised values, price opinions or internal estimates contain unobservable inputs.

The following tables present the quantitative information about non-recurring Level 3 fair value financial instruments and the fair value measurements as of June 30, 2012.

	Fair Value	Valuation Technique(s)	Unobservable Input	Range (Weighted Average)
June 30, 2012	(Dollars in thousands)			
Impaired loans held-for-investment:				
Residential mortgage loans	$140,103	Fair value of collateral	Loss severity discount	0% - 100% (47.3%)
Commercial real estate loans	$146,135	Fair value of collateral	Loss severity discount	0% - 100% (59.2%)
Repossessed assets	$107,235	Fair value of collateral	Loss severity discount	0% - 100% (40.4%)

The Company has certain impaired residential and commercial real estate loans that are measured at fair value on a nonrecurring basis. Such amounts are generally based on the fair value of the underlying collateral supporting the loan. Appraisals or other third party price opinions are generally obtained to support the fair value of the collateral and incorporate measures such as recent sales prices for comparable properties. In cases where the carrying value exceeds the fair value of the collateral less cost to sell, an impairment charge is recognized.

Repossessed assets are measured and reported at fair value through a charge-off to the allowance for loan losses based upon the fair value of the repossessed asset. The fair value of repossessed assets, upon initial recognition, are estimated using Level 3 inputs based on customized discounting criteria. The significant unobservable inputs used in the Level 3 fair value measurements of the Company's impaired loans and repossessed assets included in the table above primarily relate to internal valuations or analysis.

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Fair Value of Financial Instruments

The accounting guidance for financial instruments requires disclosures of the estimated fair value of certain financial instruments and the methods and significant assumptions used to estimate their fair values. Certain financial instruments and all non-financial instruments are excluded from the scope of this guidance. Accordingly, the fair value disclosures required by this guidance are only indicative of the value of individual financial instruments as of the dates indicated and should not be considered an indication of the fair value of the Company.

The following table presents the carrying amount and estimated fair value of certain financial instruments not recorded at fair value in entirety on a recurring basis.

	June 30, 2012				
		Estimated Fair Value			
	Carrying Value	Total	Level 1	Level 2	Level 3
	(Dollars in thousands)				
Financial Instruments					
Assets:					
Cash and cash equivalents	$1,270,389	$1,270,389	$1,270,389	$—	$—
Securities classified as trading	169,834	169,834	169,834	—	—
Securities classified as available-for-sale	424,765	424,765	100,133	224,326	100,306
Loans held-for-sale	2,459,482	2,495,820	—	2,495,820	—
Loans repurchased with government guarantees	1,999,110	1,879,164	—	1,879,164	—
Loans held-for-investment, net	6,263,257	6,273,505	—	—	6,273,505
Accrued interest receivable	103,985	103,985	—	103,985	—
Repossessed assets	107,235	107,235	—	—	107,235
FHLB stock	301,737	301,737	301,737	—	—
Mortgage servicing rights	638,865	638,865	—	—	638,865
Customer initiated derivative interest-rate swaps	4,938	4,938	—	4,938	—
Equity-linked CD purchase option	436	436	436	—	—
Liabilities:					
Retail deposits:					
Demand deposits and savings accounts	(2,949,876)	(2,876,204)	—	(2,876,204)	—
Certificates of deposit	(3,126,194)	(3,153,767)	—	(3,153,767)	—
Government accounts	(721,218)	(717,028)	—	(717,028)	—
National certificates of deposit	(339,372)	(345,264)	—	(345,264)	—
Company controlled deposits	(1,786,187)	(1,782,872)	—	(1,782,872)	—
FHLB advances	(3,400,000)	(3,672,432)	(3,672,432)	—	—
Long-term debt	(248,585)	(257,710)	—	(257,710)	—
Accrued interest payable	(12,271)	(12,271)	—	(12,271)	—
Warrant liabilities	(4,409)	(4,409)	—	(4,409)	
Litigation settlement	(19,100)	(19,100)	—	—	(19,100)
Customer initiated derivative interest-rate swaps	(4,938)	(4,938)	—	(4,938)	—
Equity-linked CD written option	(436)	(436)	(436)	—	—
Derivative Financial Instruments:					
Forward delivery contracts	(46,294)	(46,294)	—	(46,294)	—
Commitments to extend credit	132,388	132,388	—	—	132,388
U.S. Treasury and agency futures/forwards	13,414	13,414	13,414	—	—

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	December 31, 2011				
		Estimated Fair Value			
	Carrying Value	Total	Level 1	Level 2	Level 3
	(Dollars in thousands)				
Financial Instruments					
Assets:					
Cash and cash equivalents	$731,058	$731,058	$731,058	$—	$—
Securities classified as trading	313,383	313,383	313,383	—	—
Securities classified as available-for-sale	481,352	481,352	116,096	—	365,256
Loans held-for-sale	1,800,885	1,823,421	—	1,823,421	—
Loans repurchased with government guarantees	1,899,267	1,899,267	—	1,899,267	—
Loans held-for-investment, net	6,720,587	6,748,914	—	—	6,748,914
Accrued interest receivable	105,200	105,200	—	105,200	—
Repossessed assets	114,715	114,715	—	—	114,715
FHLB stock	301,737	301,737	301,737	—	—
Mortgage servicing rights	510,475	510,475	—	—	510,475
Customer initiated derivative interest-rate swaps	3,296	3,296	—	3,296	—
Liabilities:					
Retail deposits:					
Demand deposits and savings accounts	(2,520,710)	(2,440,208)	—	(2,440,208)	—
Certificates of deposit	(2,972,258)	(3,001,645)	—	(3,001,645)	—
Government accounts	(711,097)	(705,991)	—	(705,991)	—
National certificates of deposit	(384,910)	(394,442)	—	(394,442)	—
Company controlled deposits	(1,101,013)	(1,095,602)	—	(1,095,602)	—
FHLB advances	(3,953,000)	(4,195,163)	(4,195,163)	—	—
Long-term debt	(248,585)	(80,575)	—	(80,575)	—
Accrued interest payable	(8,723)	(8,723)	—	(8,723)	—
Warrant liabilities	(2,411)	(2,411)	—	(2,411)	—
Litigation settlement	(18,300)	(18,300)	—	—	(18,300)
Customer initiated derivative interest-rate swaps	(3,296)	(3,296)	—	(3,296)	—
Derivative Financial Instruments:					
Forward delivery contracts	(42,978)	(42,978)	—	(42,978)	—
Commitments to extend credit	70,965	70,965	—	—	70,965
U.S. Treasury and agency futures/forwards	12,678	12,678	12,678	—	—

The methods and assumptions were used by the Company in estimating fair value of financial instruments that were not previously disclosed.

Cash and cash equivalents. Due to their short-term nature, the carrying amount of cash and cash equivalents approximates fair value.

Loans repurchased with government guarantees. The fair value of loans is estimated by using internally developed discounted cash flow models using market interest rate inputs as well as management's best estimate of spreads for similar collateral.

Loans held-for-investment. The fair value of loans is estimated by using internally developed discounted cash flow models using market interest rate inputs as well as management's best estimate of spreads for similar collateral.

FHLB stock. No secondary market exists for FHLB stock. The stock is bought and sold at par by the FHLB. Management believes that the recorded value is the fair value.

Accrued interest receivable. The carrying amount is considered a reasonable estimate of fair value.

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Deposit accounts. The fair value of demand deposits and savings accounts approximates the carrying amount. The fair value of fixed-maturity certificates of deposit is estimated using the rates currently offered for certificates of deposit with similar remaining maturities.
FHLB advances. Rates currently available to the Company for debt with similar terms and remaining maturities are used to estimate the fair value of the existing debt.
Long-term debt. The fair value of the long-term debt is estimated based on a discounted cash flow model that incorporates the Company’s current borrowing rates for similar types of borrowing arrangements.
Accrued interest payable. The carrying amount is considered a reasonable estimate of fair value.
Fair Value Option

The Company has elected, under the fair value option in ASC 825: Financial Instruments, to record at fair value certain financial assets and financial liabilities. The fair value election is typically made on an instrument by instrument basis. The decision to measure a financial instrument at fair value cannot be revoked once the election is made. Upon adoption of Statement of Financial Accounting Standards (“SFAS”) 159: The Fair Value Option for Financial Assets and Financial Liabilities, the Company made a policy decision to elect the fair value option for loans held-for-sale originated post 2009.

The Company has elected the fair value option to account for the liability representing the obligation to make Additional Payments under the DOJ Agreement. The signed settlement contract with the DOJ establishes a legally enforceable contract with a stipulated payment plan that meets the definition of a financial liability. The Company made the fair value election as of December 31, 2011, the date the Company first recognized the financial instrument in its financial statements.

The Company elected the fair value option for held-for-sale loans and the litigation settlement liability to better reflect the management of these financial instruments on a fair value basis. Interest income on loans held-for-sale is accrued on the principal outstanding primarily using the “simple-interest” method. Interest expense on the litigation settlement will be included in the overall change in fair value of the liability each quarter.

At June 30, 2012 and December 31, 2011, the balance of the fair value of the loans held-for-sale was $2.2 billion and $1.6 billion, respectively. The change in fair value included in earnings was $176.9 million and $298.0 million for the three and six months ended June 30, 2012, respectively, compared to $82.8 million and $127.1 million for the three and six months ended June 30, 2011, respectively. Changes in fair value of the loans held-for-sale are recorded in net gain on loan sales on the Company's Consolidated Statements of Operations.

At June 30, 2012 and December 31, 2011, the balance of the fair value of the loans held-for-investment was $20.2 million and $22.7 million, respectively. The change in fair value included in earnings was $0.7 million and $(0.4) million during the three and six months ended June 30, 2012, respectively, compared to $0.3 million and $0.8 million for the three and six months ended June 30, 2011, respectively. Changes in fair value of the loans held-for-investment are reflected in interest income on loans on the Company's Consolidated Statements of Operations.

At June 30, 2012 and December 31, 2011, the fair value of financial liabilities, which related to the DOJ Agreement, was $19.1 million and $18.3 million, respectively, and included in other liabilities in the Consolidated Statements of Financial Condition. There was no increase recorded during the three months ended June 30, 2012 and a $0.8 million increase for the six months ended June 30, 2012, primarily representing the recognition of the periodic effect of discounting. The increase was recorded in general and administrative expense within non-interest expense on the Consolidated Statements of Operations.

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The following table reflects the difference between the aggregate fair value and aggregate remaining contractual principal balance outstanding as of June 30, 2012 and December 31, 2011 for assets and liabilities for which the fair value option has been elected.

	June 30, 2012 (Dollars in thousands)			December 31, 2011		
	Unpaid Principal Balance ("UPB")	Fair Value	Fair Value Over / (Under) UPB	Unpaid Principal Balance	Fair Value	Fair Value Over / (Under) UPB
Assets						
Nonaccrual loans:						
Loans held-for-sale	$—	$—	$—	$281	$291	$10
Loans held-for-investment	2,907	2,847	(60)	2,989	2,963	(26)
Total loans	2,907	2,847	(60)	3,270	3,254	(16)
Other performing loans:						
Loans held-for-sale	2,084,156	2,195,679	111,523	1,570,302	1,629,327	59,025
Loans held-for-investment	16,451	17,384	933	18,699	19,688	989
Total loans	2,100,607	2,213,063	112,456	1,589,001	1,649,015	60,014
Total loans:						
Loans held-for-sale	2,084,156	2,195,679	111,523	1,570,583	1,629,618	59,035
Loans held-for-investment	19,358	20,231	873	21,688	22,651	963
Total loans	$2,103,514	$2,215,910	$112,396	$1,592,271	$1,652,269	$59,998
Liabilities						
Litigation settlement	N/A (1)	$(19,100)	N/A (1)	N/A (1)	$(18,300)	N/A (1)

(1) Remaining principal outstanding is not applicable to the litigation settlement because it does not obligate the Company to return a stated amount of principal at maturity, but instead return an amount based upon performance on the underlying terms in the Agreement.

Note 4 – Investment Securities

As of June 30, 2012 and December 31, 2011, investment securities were comprised of the following.

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
June 30, 2012				
Securities classified as trading:				
U.S. Treasury bonds	$169,988	$—	$(154)	$169,834
Securities classified as available-for-sale:				
Non-agency collateralized mortgage obligations	$325,260	$—	$(20,628)	$304,632
U.S. government sponsored agencies	97,219	2,914	—	100,133
Municipal obligations	20,000	—	—	20,000
Total securities classified as available-for-sale	$442,479	$2,914	$(20,628)	$424,765
December 31, 2011				
Securities classified as trading:				
U.S. Treasury bonds	$291,809	$21,574	$—	$313,383
Securities classified as available-for-sale:				
Non-agency collateralized mortgage obligations	401,273	—	(36,017)	365,256
U.S. government sponsored agencies	113,885	2,211	—	116,096

Total securities classified as available-for-sale	$515,158	$2,211	$(36,017)	$481,352

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Trading

Securities classified as trading are comprised of AAA-rated U.S. Treasury bonds. U.S. Treasury bonds held in trading are distinguished from available-for-sale based upon the intent of the Company to use them as an economic offset against changes in the valuation of the MSR portfolio; however, these securities do not qualify as an accounting hedge.

For U.S. Treasury bonds held, the Company recorded an unrealized loss of $15.8 million and $21.7 million during the three and six months ended June 30, 2012, respectively, compared to an unrealized gain of $0.1 million during both the three and six months ended June 30, 2011, respectively. Additionally, the Company recorded a realized gain of $19.5 million on the sale of U.S. Treasury bonds for the three and six months ended June 30, 2012, compared to no sales for the same periods ending June 30, 2011.

Available-for-Sale

At June 30, 2012 and December 31, 2011, the Company had $424.8 million and $481.4 million, respectively, in securities classified as available-for-sale which were comprised of U.S. government sponsored agency and non-agency collateralized mortgage obligations ("CMOs") and municipal obligations. Securities available-for-sale are carried at fair value, with unrealized gains and losses reported as a component of other comprehensive loss to the extent they are temporary in nature or "other than temporary impairments" ("OTTI") as to non credit related issues. If unrealized losses are, at any time, deemed to have arisen from OTTI, then the credit related portion is reported as an expense for that period.

The following table summarizes by duration the unrealized loss positions, at June 30, 2012 and December 31, 2011, on securities classified as available-for-sale.

	Unrealized Loss Position with Duration 12 Months and Over			Unrealized Loss Position with Duration Under 12 Months		
	Fair Value	Number of Securities	Unrealized Loss	Fair Value	Number of Securities	Unrealized Loss
Type of Security	(Dollars in thousands)					
June 30, 2012						
Non-agency CMOs	$279,914	9	$(20,628)	$—	—	$—
December 31, 2011						
Non-agency CMOs	$318,843	10	$(34,046)	$46,413	2	$(1,971)

The unrealized losses on securities available-for-sale amounted to $20.6 million on non-agency CMOs at June 30, 2012. The unrealized losses on securities available-for-sale were $36.0 million on non-agency CMOs at December 31, 2011. These CMOs consist of interests in investment vehicles backed by residential first mortgage loans.

Generally, an investment impairment analysis is performed every three months. Before an analysis is performed, the Company reviews the general market conditions for the specific type of underlying collateral of each of the CMOs and municipal obligations; in this case, the mortgage market in general has suffered from significant losses in value. With the assistance of third party experts as deemed necessary, the Company models the expected cash flows of the underlying mortgage assets using historical factors such as default rates, current delinquency rates and estimated factors such as prepayment speed, default speed and severity speed. Next, the cash flows are modeled through the appropriate waterfall for each CMO tranche owned; the level of credit support provided by subordinated tranches is included in the waterfall analysis. The resulting cash flow of principal and interest is then utilized by management to determine the amount of credit losses by security.

The credit losses on the portfolio reflect the economic conditions present in the United States over the course of the last several years and the forecasted effect of changes in such conditions, including changes in the forecasted level of home prices. This includes high mortgage defaults, declines in collateral values and changes in homeowner behavior,

such as intentionally defaulting on a note due to a home value worth less than the outstanding debt on the home (so-called “strategic defaults”).

During the three and six months ended June 30, 2012, the Company recognized $1.0 million and $2.2 million, respectively, of OTTI on CMOs, which were recognized on seven securities that had losses prior to June 30, 2012, primarily due to forecasted credit losses. At June 30, 2012, the Company had total OTTI of $50.8 million on 9 CMOs, with existing OTTI in the available-for-sale portfolio, of which $5.0 million net loss was recognized in other comprehensive income. During both the three and six months ended June 30, 2011, there was $15.6 million on additional OTTI due to credit losses on CMOs. All OTTI due to credit

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losses was recognized in current operations. At December 31, 2011, the cumulative amount of OTTI due to credit losses totaled $59.4 million on 11 CMOs in the available-for-sale portfolio. The impairment losses arising from credit related matters were reported in the Consolidated Statements of Operations. The following table shows the activity for OTTI credit loss.

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2012	2011	2012	2011
	(Dollars in thousands)			
Beginning balance of amount related to credit losses on CMOs	$(53,998)	$(38,743)	$(59,376)	$(40,045)
Reductions for increases in cash flows expected to be collected that are recognized over the remaining life of the CMO	2,639	1,216	5,600	2,518
Reductions for CMOs sold during the period (realized)	1,555	—	5,147	—
Additions for the amount related to the credit loss for which an OTTI impairment was not previously recognized	(1,017)	(15,584)	(2,192)	(15,584)
Ending balance of amount related to credit losses on CMOs	$(50,821)	$(53,111)	$(50,821)	$(53,111)

Gains (losses) on the sale of U.S. government sponsored agency mortgage-backed securities available-for-sale that are recently created with underlying mortgage products originated by the Bank are reported within net gain on loan sale. Securities in this category have typically remained in the portfolio less than 90 days before sale. During the three and six months ended June 30, 2012 and 2011, there were no sales of agency securities with underlying mortgage products recently originated by the Bank.

Gain (losses) on sales for all other available-for-sale securities types are reported in “net gain on securities available-for-sale” in the Consolidated Statements of Operations. During the three and six months ended June 30, 2012, the Company had $19.1 million and $39.6 million, respectively, in sales of non-agency securities resulting in a gain of less than $0.1 million and $0.3 million, respectively, compared to no sales of agency and non-agency securities for the three and six months ended June 30, 2011.

At June 30, 2012 and December 31, 2011, the aggregate amount of available-for-sale securities from each of the following non-agency CMO issuers was greater than 10 percent of the Company’s stockholders’ equity.

	June 30, 2012		December 31, 2011	
	Amortized Cost	Fair Market Value	Amortized Cost	Fair Market Value
Name of Issuer	(Dollars in thousands)			
Countrywide Home Loans	$121,677	$116,708	$134,993	$124,313
Flagstar Home Equity Loan Trust 2006-1 (1)	—	—	123,251	110,328
Total	$121,677	$116,708	$258,244	$234,641

(1) As of March 31, 2012 , Flagstar Home Equity Loan Trust 2006-1 available-for-sale security no longer represents 10 percent of the Company's stockholders' equity.

Note 5 – Loans Held-for-Sale

Total loans held-for-sale were $2.5 billion and $1.8 billion at June 30, 2012 and December 31, 2011, respectively, and were comprised primarily of residential first mortgage loans. During the six months ended June 30, 2012, the Company sold $10.8 million of non-performing residential first mortgage loans in the held-for-sale category at a sale price which approximated carrying value.

At June 30, 2012 and December 31, 2011, $2.2 billion and $1.6 billion of loans held-for-sale were recorded at fair value, respectively. The Company estimates the fair value of mortgage loans based on quoted market prices for securities backed by similar types of loans for which quoted market prices were available. Otherwise, the fair values of loans were estimated by discounting estimated cash flows using management's best estimate of market interest rates for similar collateral.

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Note 6 – Loans Repurchased With Government Guarantees

Pursuant to Ginnie Mae servicing guidelines, the Company has the unilateral option to repurchase certain delinquent loans (loans past due 90 days or more) securitized in Ginnie Mae pools, if the loans meet defined criteria. As a result of this unilateral option, once the delinquency criteria have been met, and regardless of whether the repurchase option has been exercised, the Company must treat the loans as having been repurchased and recognize the loans as loans held-for-sale on the Consolidated Statement of Financial Condition and also recognize a corresponding liability for a similar amount. If the loans are actually repurchased, the Company transfers the loans to loans repurchased with government guarantees and eliminates the corresponding liability. At June 30, 2012, the amount of such loans actually repurchased totaled $2.0 billion and were classified as loans repurchased with government guarantees, and those loans which the Company had not yet repurchased but had the unilateral right to repurchase totaled $83.6 million and were classified as loans held-for-sale. At December 31, 2011, the amount of such loans actually repurchased totaled $1.9 billion and were classified as loans repurchased with government guarantees, and those loans which the Company had not yet repurchased but had the unilateral right to repurchase totaled $117.2 million and were classified as loans held-for-sale.

Substantially all of these loans continue to be insured or guaranteed by the FHA, and the Company's management believes that the reimbursement process is proceeding appropriately. On average, claims have historically been filed and paid in approximately 18 months from the date of the initial delinquency; however increasing volumes throughout the country, as well as changes in the foreclosure process in certain states and other forms of government intervention may result in changes to the historical norm. These repurchased loans earn interest at a statutory rate, which varies and is based upon the 10-year U.S. Treasury note rate at the time the underlying loan becomes delinquent.

Note 7 – Loans Held-for-Investment

Loans held-for-investment are summarized as follows.

	June 30, 2012	December 31, 2011
	(Dollars in thousands)	
Consumer loans:		
Residential first mortgage	$3,102,137	$3,749,821
Second mortgage	127,434	138,912
Warehouse lending	1,261,442	1,173,898
HELOC	198,228	221,986
Other	57,605	67,613
Total consumer loans	4,746,846	5,352,230
Commercial loans:		
Commercial real estate	1,075,015	1,242,969
Commercial and industrial	569,288	328,879
Commercial lease financing	159,108	114,509
Total commercial loans	1,803,411	1,686,357
Total consumer and commercial loans held-for-investment	6,550,257	7,038,587
Less allowance for loan losses	(287,000)	(318,000)
Loans held-for-investment, net	$6,263,257	$6,720,587

For the three and six months ended June 30, 2012, the Company transferred $5.3 million and $18.5 million, respectively, in loans held-for-sale to loans held-for-investment. The loans transferred were carried at fair value, and will continue to be reported at fair value while classified as held-for-investment. During the three and six months ended June 30, 2011, the Company transferred $5.4 million and $12.5 million, respectively, in loans held-for-sale to loans to held-for-investment.

The Company’s commercial leasing activities consist primarily of equipment leases. Generally, lessees are responsible for all maintenance, taxes, and insurance on leased properties. The following table lists the components of the net

investment in financing leases.

	June 30, 2012	December 31, 2011
	(Dollars in thousands)	
Total minimum lease payment to be received	$159,445	$115,216
Estimated residual values of lease properties	9,951	6,967
Unearned income	(12,356)	(8,894)
Net deferred fees and other	2,068	1,220
Net investment in commercial financing leases	$159,108	$114,509

Accounting standards require a reserve to be established as a component of the allowance for loan losses when it is probable all amounts due will not be collected pursuant to the contractual terms of the loan and the recorded investment in the loan exceeds its fair value. Fair value is measured using either the present value of the expected future cash flows discounted at the loan's effective interest rate, the observable market price of the loan, or the fair value of the collateral if the loan is collateral dependent, reduced by estimated disposal costs.

Nonperforming commercial and commercial real estate loans are considered to be impaired and typically have an allowance allocated based on the underlying collateral's appraised value, less management's estimates of costs to sell. In estimating the fair value of collateral, the Company utilizes outside fee-based appraisers to evaluate various factors such as occupancy and rental rates in our real estate markets and the level of obsolescence that may exist on assets acquired from commercial business loans. Appraisals are updated at least annually but may be obtained more frequently if changes to the property or market conditions warrant.
Impaired residential loans include loan modifications considered to be TDRs and certain nonperforming loans that have been charged-down to collateral value. Fair value of nonperforming residential mortgage loans, including redefaulted TDRs and certain other severely past due loans, is based on the underlying collateral's value obtained through appraisals or broker's price opinions, updated at least semi-annually, less management's estimates of cost to sell. The allowance allocated to TDRs performing under the terms of their modification is typically based on the present value of the expected future cash flows discounted at the loan's effective interest rate, on a pooled basis, as these loans are not considered to be collateral dependent.

For those loans not individually evaluated for impairment, management has sub-divided the commercial and consumer loans into homogeneous portfolios.

As part of the Company's ongoing risk assessment process which remains focused on the impacts of the current economic environment and the related borrower repayment behavior on the Company's credit performance, management continues to back test and validate the results of quantitative and qualitative modeling of the risk in loans held-for-investment portfolio, in efforts to use the best quality information available. This is consistent with the expectations of the Bank's primary regulator and a continuing evaluation of the performance dynamics within the mortgage industry. As a result of an analysis completed during the first quarter 2012, the Company determined it was appropriate to make refinements to its allowance for loan loss methodology and related model. Such refinements included improved risk segmentation and quantitative analysis, and enhancements to and alignment of the qualitative risk factors.
The impact of the refinements adopted during the first quarter 2012 resulted in an increase to the Company's allowance for loan loss of $59.0 million in the consumer portfolio and $11.0 million in the commercial portfolio. The following key refinements were made:
First, the Company utilized refined segmentation and more formal qualitative factors during the first quarter 2012, which resulted in an increase in the adjusted historical factors used to calculate the ASC 450-20 allowance related to the consumer portfolio. Historically, the Company segmented the population of consumer loans held-for-investment (“LHFI”) by product type and by delinquency status for purposes of estimating an adequate allowance for loan losses.

The Company performed a thorough analysis of the largest product type, residential first mortgage loans, to assess the relative reliability of its risk segmentation in connection with the ability to detect losses inherent in the portfolio, and determined that there was a higher correlation of loan losses to LTV ratios than to delinquency status. As a result, the Company refined the process to use LTV segmentation, rather than product and delinquency segmentation, as the more appropriate consumer residential loan characteristic in determining the related allowance for loan losses.

Additionally, the Company created a more formal process and framework surrounding the qualitative factors and better aligned the factors with regulatory guidance and the changes in the mortgage environment. The Company formally implemented a qualitative factor matrix related to each loan class in the consumer portfolio in the first quarter 2012, which includes the following factors: changes in lending policies and procedures, changes in economic and business conditions, changes in the nature and volume of the portfolio, changes in lending management, changes in credit quality statistics, changes in the quality of the loan review system, changes in the value of underlying collateral for collateral-dependent loans, changes in concentrations of credit, and other external factor changes. These factors are used to reflect changes in the collectability of the portfolio not captured by the historical loss rates. As such, the qualitative factors supplement actual loss experience and allow the Company to better estimate the loss within the loan portfolios based upon market and other indicators. Qualitative factors are analyzed to determine a quantitative impact of each factor which adjusts the historical loss rate. Adjusted historical loss rates are then used in the calculation of the allowance for loan losses. The adjusted historical loss rates in 2012 were higher than those used in the calculation of the consumer allowance for loan losses in 2011, thereby resulting in an increase to the 2012 level of allowance for loan losses.

Second, to allow the Company the appropriate amount of time to analyze portfolio statistics and allow for the appropriate validation of the reasonableness of the new qualitative factors, management adjusted the historical look back period for loss rates to lag a quarter (as compared to the previous policy of a month). This adjustment resulted in a decrease to the 2012 level of allowance for loan losses, as compared to the 2011 level of allowance for loan losses, partially offsetting the increase resulting from the refined segmentation.

Third, the commercial loan portfolio was segmented into commercial “legacy” loans (loans originated prior to January 1, 2011) and commercial “new” loans (loans originated on or after January 1, 2011) while still retaining the segmentation by product type. Due to the changes in the Company's strategy and to changes in underwriting and origination practices and controls related to that strategy, the Company determined the refined segmentation better reflected the dynamics in the two portfolios. The loss rates attributed to the “legacy” portfolio are based on historical losses of this segment. Due to the brief period of time that loans in the “new” portfolio were outstanding, and thus the absence of a sufficient loss history for that portfolio, the Company had used loss data from a third party data aggregation firm (adjusting for our qualitative factors) as a proxy for estimating an allowance for loan losses on the “new” portfolio. As a refinement in the first quarter 2012, the Company separately identified a population of commercial banks with similar size balance sheets (and loan portfolios) to serve as our peer group. The Company now uses this peer group's publicly available historical loss data (adjusted for our qualitative factors) as a new proxy for loss rates used to determine the allowance for loan losses on the “new” commercial portfolio. This refined segmentation resulted in an increase to the 2012 level of allowance for loan losses, as compared to the 2011 level of allowance for loan losses.

Fourth, as a result of these refinements (in addition to the refinements noted below), the Company has determined that it no longer requires an unallocated portion of allowance for loan losses. The Company expects to review these models on an ongoing basis and update them as appropriate to reflect then-current industry conditions, heightened access to enhanced loss data, and refinements based upon continuous back testing of the allowance for loan losses model. This change to the unallocated reserve resulted in a decrease to the 2012 level of allowance for loan losses, as compared to the 2011 level of allowance for loan losses.

Lastly, part of the increase in allowance for loan losses was a result of the TDR refinement. Historically, the Company performed impairment analysis on TDRs by using the discounted cash flows method on a portfolio or pooled approach

when the TDRs were not deemed collateral dependent. During the fourth quarter 2011, the Company adopted a strategic focus that improved loss mitigation processes so that the Company could continue the rate of loan modifications and other loss mitigation activities. Due to the emphasis on loss mitigation activities, the Company implemented new procedures relating to “new” TDRs (loans that were designated TDRs generally beginning on or after October 1, 2011) to capture the necessary data to perform the impairment analysis on a portfolio level. Such data was not previously available and currently continues to not be available for loans designated as TDRs prior to September 30, 2011. This data is now being captured in part due to the loan servicing system conversion in late 2011. As such, for a significant percentage of “new” TDRs, management was able to perform the impairment calculation on a portfolio basis. Given data constraints the “old” TDR portfolio as of December 31, 2011, is still utilizing the pooled approach. This refinement resulted in an increase to the 2012 level of allowance for loan losses, as compared to the 2011 level of allowance for loan losses. The Company expects to continue to refine this process for operational efficiency purposes that will allow for periodic review and updates of impairment data of all TDRs grouped by similar risk characteristics.

The allowance for loan losses by class of loan is summarized in the following tables.

	Residential First Mortgage	Second Mortgage	Warehouse Lending	HELOC	Other Consumer	Commercial Real Estate	Commercial and Industrial	Commercial Lease Financing	Total
	(Dollars in thousands)								
For the Three Months Ended June 30, 2012									
Beginning balance allowance for loan losses	$158,661	$19,067	$1,824	$14,778	$2,593	$71,470	$9,953	$2,654	$281,000
Charge-offs	(22,570)	(4,057)	—	(4,257)	(728)	(31,277)	(23)	—	(62,912)
Recoveries	6,582	1,039	—	93	395	2,344	31	—	10,484
Provision	33,043	4,034	(268)	7,239	325	15,870	(1,453)	(362)	58,428
Ending balance allowance for loan losses	$175,716	$20,083	$1,556	$17,853	$2,585	$58,407	$8,508	$2,292	$287,000
For the Three Months Ended June 30, 2011									
Beginning balance allowance for loan losses	$128,038	$22,095	$2,017	$19,367	$5,180	$92,404	$1,648	$251	$271,000
Charge-offs	(9,441)	(6,138)	(288)	(4,925)	(507)	(25,957)	(9)	—	(47,265)
Recoveries	342	344	—	443	290	462	—	—	1,881
Provision	26,088	3,796	(109)	3,806	(22)	14,219	681	(75)	48,384
Ending balance allowance for loan losses	$145,027	$20,097	$1,620	$18,691	$4,941	$81,128	$2,320	$176	$274,000
For the Six Months Ended June 30, 2012									
Beginning balance allowance for	$179,218	$16,666	$1,250	$14,845	$2,434	$96,984	$5,425	$1,178	$318,000

loan losses									
Charge-offs	(118,002)	(9,340)	—	(10,676)	(1,918)	(76,310)	(1,604)	—	(217,850)
Recoveries	7,132	1,288	—	350	607	4,336	36	—	13,749
Provision	107,368	11,469	306	13,334	1,462	33,397	4,651	1,114	173,101
Ending balance allowance for loan losses	$175,716	$20,083	$1,556	$17,853	$2,585	$58,407	$8,508	$2,292	$287,000
For the Six Months Ended June 30, 2011									
Beginning balance allowance for loan losses	$119,400	$25,186	$4,171	$24,819	$5,445	$93,437	$1,542	$ —	$274,000
Charge-offs	(12,543)	(11,916)	(288)	(9,988)	(1,346)	(45,246)	(57)	—	(81,384)
Recoveries	827	1,210	5	929	529	1,191	—	—	4,691
Provision	37,343	5,617	(2,268)	2,931	313	31,746	835	176	76,693
Ending balance allowance for loan losses	$145,027	$20,097	$1,620	$18,691	$4,941	$81,128	$2,320	$ 176	$274,000

	Residential First Mortgage	Second Mortgage	Warehouse Lending	HELOC	Other Consumer	Commercial Real Estate	Commercial and Industrial	Commercial Lease Financing	Total
	(Dollars in thousands)								
June 30, 2012									
Loans held-for-investment									
Individually evaluated (1)	$755,580	$16,575	$275	$438	$83	$176,370	$91	$—	$949,412
Collectively evaluated (2)	2,346,557	110,859	1,261,167	197,790	57,522	898,645	569,197	159,108	5,600,845
Total loans	$3,102,137	$127,434	$1,261,442	$198,228	$57,605	$1,075,015	$569,288	$159,108	$6,550,257
Allowance for loan losses									
Individually evaluated (1)	$99,829	$5,429	$—	$2,780	$83	$9,704	$23	$—	$117,848
Collectively evaluated (2)	75,887	14,654	1,556	15,073	2,502	48,703	8,485	2,292	169,152
Total allowance for loan losses	$175,716	$20,083	$1,556	$17,853	$2,585	$58,407	$8,508	$2,292	$287,000
December 31, 2011									
Loans held-for-investment									
Individually evaluated (1)	$744,604	$14,237	$307	$1,775	$2	$207,144	$2,402	$—	$970,471
Collectively evaluated (2)	3,005,217	124,675	1,173,591	220,211	67,611	1,035,825	326,477	114,509	6,068,116
Total loans	$3,749,821	$138,912	$1,173,898	$221,986	$67,613	$1,242,969	$328,879	$114,509	$7,038,587
Allowance for loan losses									
	$113,569	$4,738	$—	$1,775	$2	$53,146	$1,588	$—	$174,818

Individually evaluated (1)									
Collectively evaluated (2)	65,649	11,928	1,250	13,070	2,432	43,838	3,837	1,178	143,182
Total allowance for loan losses	$179,218	$16,666	$1,250	$14,845	$2,434	$96,984	$5,425	$1,178	$318,000

(1) Represents loans individually evaluated for impairment in accordance with ASC 310-10, Receivables (formerly FAS 114), and pursuant to amendments by ASU 2010-20 regarding allowance for impaired loans.

(2) Represents loans collectively evaluated for impairment in accordance with ASC 450-20, Loss Contingencies (formerly FAS 5), and pursuant to amendments by ASU 2010-20 regarding allowance for unimpaired loans.

The following table presents an age analysis of past due loans by class of loan.

	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Current	Total Investment Loans	90 Days and Still Accruing
	(Dollars in thousands)						
June 30, 2012							
Consumer loans:							
Residential first mortgage	$55,590	$22,252	$282,898	$360,740	$2,741,397	$3,102,137	$ —
Second mortgage	1,632	589	6,147	8,368	119,066	127,434	—
Warehouse lending	—	—	28	28	1,261,414	1,261,442	—
HELOC	4,204	1,756	4,126	10,086	188,142	198,228	—
Other	697	165	275	1,137	56,468	57,605	9
Total consumer loans	62,123	24,762	293,474	380,359	4,366,487	4,746,846	9
Commercial loans:							
Commercial real estate	1,718	2,345	138,069	142,132	932,883	1,075,015	5,486
Commercial and industrial	1	—	56	57	569,231	569,288	—
Commercial lease financing	—	—	—	—	159,108	159,108	—
Total commercial loans	1,719	2,345	138,125	142,189	1,661,222	1,803,411	5,486
Total loans	$63,842	$27,107	$431,599	$522,548	$6,027,709	$6,550,257	$ 5,495
December 31, 2011							
Consumer loans:							
Residential first mortgage	$74,934	$37,493	$372,514	$484,941	$3,264,880	$3,749,821	$ —
Second mortgage	1,887	1,527	6,236	9,650	129,262	138,912	—
Warehouse lending	—	—	28	28	1,173,870	1,173,898	—
HELOC	5,342	2,111	7,973	15,426	206,560	221,986	—
Other	1,507	471	611	2,589	65,024	67,613	34
Total consumer loans	83,670	41,602	387,362	512,634	4,839,596	5,352,230	34
Commercial loans:							
Commercial real estate	7,453	12,323	99,335	119,111	1,123,858	1,242,969	5,536
Commercial and industrial	11	62	1,670	1,743	327,136	328,879	65
Commercial lease financing	—	—	—	—	114,509	114,509	—
Total commercial loans	7,464	12,385	101,005	120,854	1,565,503	1,686,357	5,601
Total loans	$91,134	$53,987	$488,367	$633,488	$6,405,099	$7,038,587	$ 5,635

Loans on which interest accruals have been discontinued totaled approximately $426.1 million and $482.7 million at June 30, 2012 and December 31, 2011, respectively. Interest on these loans is recognized as income when collected. Interest that would have been accrued on such loans totaled approximately $5.8 million and $10.6 million during the three and six months ended June 30, 2012, respectively, compared to $5.7 million and $11.1 million during the three and six months ended June 30, 2011.

Loan Modifications

A portion of the Company's residential first mortgages have been modified under Company-developed programs. These programs first require an extension of term followed by a reduction of the interest rate. During the six months ended June 30, 2012, 695 accounts with an aggregate balance of $188.2 million residential first mortgage loans have been modified and were still outstanding. For the year ended December 31, 2011, 489 accounts with an aggregate balance of $181.0 million residential first mortgage loans have been modified and were still outstanding.

At June 30, 2012 and December 31, 2011, approximately $8.5 million and $47.2 million, respectively, in commercial loan balances had been modified, primarily consisting of commercial real estate loans.

Periodically, the Company will restructure a note into two separate notes (A/B structure), charging off the entire B note. The A note is structured with appropriate loan-to-value and cash flow coverage ratios that provide for a high likelihood of repayment. The A note is classified as a non-performing note until the borrower has displayed a historical payment performance for a reasonable period of time subsequent to the restructuring. A period of sustained repayment for at least six months generally is required to return the note to accrual status provided that management has determined that the performance is reasonably expected to continue. The A note will be classified as a restructured note (either performing or nonperforming) through the calendar year in which historical payment performance on the restructured note has been established. At June 30, 2012 and December 31, 2011, there was approximately $10.0 million and $21.8 million, respectively, in carrying amount representing eight and ten A/B structures, respectively.

Troubled Debt Restructurings

The following table provides a summary of TDRs by type and performing status.

	TDRs		
	Performing	Non-performing	Total
June 30, 2012	(Dollars in thousands)		
Consumer loans: (1)			
Residential first mortgage	$561,639	$ 122,299	$683,938
Second mortgage	12,448	3,881	16,329
Other consumer	272	132	404
Total consumer loans	574,359	126,312	700,671
Commercial loans: (2)			
Commercial real estate	1,703	6,776	8,479
Commercial and industrial	35	—	35
Total commercial loans	1,738	6,776	8,514
Total TDRs	$576,097	$ 133,088	$709,185
December 31, 2011			
Consumer loans: (1)			
Residential first mortgage	$488,896	$ 165,655	$654,551
Second mortgage	10,542	1,419	11,961
Other consumer	—	2	2
Total consumer loans	499,438	167,076	666,514
Commercial loans: (2)			
Commercial real estate	17,737	29,509	47,246
Total TDRs	$517,175	$ 196,585	$713,760

(1)

The allowance for loan losses on consumer TDR loans totaled $102.0 million and $85.2 million at June 30, 2012 and December 31, 2011, respectively.

(2) The allowance for loan losses on commercial TDR loans totaled $0.6 million and $32.2 million at June 30, 2012 and December 31, 2011, respectively.

TDRs returned to performing (accrual) status totaled $3.3 million and $25.7 million during the three and six months ended June 30, 2012, respectively, and are excluded from non-performing loans, compared to $3.5 million and $18.5 million during the three and six months ended June 30, 2011. TDRs that have demonstrated a period of at least six months of consecutive performance under the modified terms, are returned to performing (i.e., accrual) status and are excluded from non-performing loans. Although these TDRs have been returned to performing status, they will still continue to be classified as impaired until they are repaid in full, or foreclosed and sold, and included as such in the tables within "repossessed assets." At June 30, 2012 and December 31, 2011, remaining commitments to lend additional funds to debtors whose terms have been modified in a commercial or consumer TDR were immaterial.

Some loan modifications classified as TDRs may not ultimately result in the full collection of principal and interest, as modified, but instead give rise to potential incremental losses. Such losses are factored into the Company's allowance for loan losses estimate. Once a loan becomes a TDR, it will continue to be reported as a TDR, regardless of performance, until it is ultimately repaid in full, sold, or foreclosed upon. The impairment of TDRs is measured in accordance with ASC 310-10 (see the table below presenting impaired loans with change in allowance upon modification). Management uses the pooling method to measure impairment under ASC 310-10 for certain loans in its portfolio and also individually measures impairment under ASC 310-10 for other loans in the portfolio depending on the risk characteristics underlying the loan and the availability of data. Management expects to continue to refine this process for operational efficiency purposes that will allow for periodic review and updates of impairment data of TDRs grouped by similar risk characteristics. The Company measures impairment using the discounted cash flow method for performing TDRs and measures impairment based on collateral values for re-defaulted TDRs. The Company has allocated reserves in the allowance for loan loss for the TDR portfolio of $102.6 million and $117.4 million at June 30, 2012, and December 31, 2011, respectively.

The following table presents the three and six months ended June 30, 2012 and 2011 number of accounts, pre-modification unpaid principal balance, and post-modification unpaid principal balance that were new modified TDRs during the three and six months ended June 30, 2012. In addition, the table presents the number of accounts and unpaid principal balance of loans that have subsequently defaulted during the three and six months ended June 30, 2012 and 2011 that had been modified in a TDR during the 12 months preceding each quarterly period. All TDR classes within consumer and commercial loan portfolios are considered subsequently defaulted as of greater than 90 days past due.

For the Three Months Ended June 30, 2012	Number of Accounts	Pre-Modification Unpaid Principal Balance	Post-Modification Unpaid Principal Balance (1)	Increase (Decrease) in Allowance at Modification
		(Dollars in thousands)		
New TDRs				
Residential first mortgages	255	$80,109	$83,545	$14,834
Second mortgages	73	3,688	3,196	(44)
Other consumer	13	524	403	7
Total TDR loans	341	$84,321	$87,144	$14,797
TDRs that subsequently defaulted in previous 12 months (2)	Number of Accounts	Unpaid Principal Balance		Increase in Allowance at Subsequent Default
Residential first mortgages	15		$4,216	$1,182
Second mortgages	5		293	256
Total TDR loans	20		$4,509	$1,438

For the Three Months Ended June 30, 2011	Number of Accounts	Pre-Modification Unpaid Principal Balance	Post-Modification Unpaid Principal Balance (1)	Increase in Allowance at Modification
New TDRs				
Residential first mortgages	57	$14,828	$15,342	$90
Second mortgages	7	503	507	—
Commercial real estate	1	1,129	1,129	—
Total TDR loans	65	$16,460	$16,978	$90

TDRs that subsequently defaulted in previous 12 months (2)	Number of Accounts	Unpaid Principal Balance		Increase in Allowance at Subsequent Default
Residential first mortgages	54		$21,478	$327
Second mortgages	4		369	—
Commercial real estate	1		85	—
Total TDR loans	59		$21,932	$327

For the Six Months Ended June 30, 2012	Number of Accounts	Pre-Modification Unpaid Principal Balance	Post-Modification Unpaid Principal Balance (1)	Increase (Decrease) in Allowance at Modification
New TDRs				
Residential first mortgages	536	$180,917	$184,200	$23,323
Second mortgages	148	9,207	6,407	(156)
Other consumer	19	779	637	9
Total TDR loans	703	$190,903	$191,244	$23,176

TDRs that subsequently defaulted in previous 12 months (2)	Number of Accounts	Unpaid Principal Balance		Increase in Allowance at Subsequent Default
Residential first mortgages	25		$6,460	$1,403
Second mortgages	5		293	256
Total TDR loans	30		$6,753	$1,659

For the Six Months Ended June 30, 2011	Number of Accounts	Pre-Modification Unpaid Principal Balance	Post-Modification Unpaid Principal Balance (1)	Increase (Decrease) in Allowance at Modification
New TDRs				
Residential first mortgages	189	$54,622	$56,136	$1,004
Second mortgages	21	1,334	1,346	(1)
Commercial real estate	6	11,558	8,803	(1,011)
Total TDR loans	216	$67,514	$66,285	$(8)

TDRs that subsequently defaulted in previous 12 months (2)	Number of Accounts	Unpaid Principal Balance		Increase in Allowance at Subsequent Default
Residential first mortgages	110		$41,750	$987
Second mortgages	8		786	—
Commercial real estate	1		85	—

Total TDR loans	119		$42,621	$987

(1) Post-modification balances include past due amounts that are capitalized at modification date.

(2) Subsequent default is defined as a payment re-defaulted within 12 months of the restructuring date.

The following table presents impaired loans with no related allowance and with an allowance recorded.

	June 30, 2012			December 31, 2011		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
	(Dollars in thousands)					
With no related allowance recorded:						
Consumer loans:						
Residential first mortgage loans	$137,675	$227,523	$—	$45,604	$45,604	$—
Second mortgage	1,564	1,564	—	—	—	—
Warehouse lending	275	869	—	307	869	—
Commercial loans:						
Commercial real estate	119,500	179,988	—	47,564	49,156	—
	$259,014	$409,944	$—	$93,475	$95,629	$—
With an allowance recorded:						
Consumer loans:						
Residential first mortgage	$617,903	$617,488	$99,829	$699,000	$699,000	$113,569
Second mortgage	15,012	15,914	5,429	14,237	14,237	4,738
HELOC	438	1,808	2,780	1,775	1,775	1,775
Other consumer	83	83	83	2	2	2
Commercial loans:						
Commercial real estate	56,871	73,535	9,704	159,581	166,874	53,145
Commercial and industrial (1)	91	162	23	2,402	2,402	1,588
	$690,398	$708,990	$117,848	$876,997	$884,290	$174,817
Total						
Consumer loans:						
Residential first mortgage	$755,578	$845,011	$99,829	$744,604	$744,604	$113,569
Second mortgage	16,576	17,478	5,429	14,237	14,237	4,738
Warehouse lending	275	869	—	307	869	—
HELOC	438	1,808	2,780	1,775	1,775	1,775
Other consumer	83	83	83	2	2	2
Commercial loans:						
Commercial real estate	176,371	253,523	9,704	207,145	216,030	53,145
Commercial and industrial (1)	91	162	23	2,402	2,402	1,588
Total impaired loans	$949,412	$1,118,934	$117,848	$970,472	$979,919	$174,817

(1) These impaired loans are from originations prior to 2011.

For the Three Months Ended June 30,		For the Six Months Ended June 30,	
2012	2011	2012	2011

	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(Dollars in thousands)							
Consumer loans:								
Residential first mortgage	$733,728	$ 28,434	$578,891	$ 6,409	$737,353	$ 35,638	$585,348	$ 12,135
Second mortgage	15,742	302	13,380	149	15,240	484	13,391	288
Warehouse lending	291	—	—	—	296	—	—	—
HELOC	255	1	13	—	762	4	17	—
Other consumer	42	—	—	—	29	—	—	—
Commercial loans:								
Commercial real estate	175,308	588	200,730	1,925	185,920	1,903	206,807	3,739
Commercial and industrial (1)	138	1	1,617	—	892	5	1,617	372
Total impaired loans	$925,504	$ 29,326	$794,631	$ 8,483	$940,492	$ 38,034	$807,180	$ 16,534

(1) These impaired loans are from originations prior to 2011.

The Company utilizes an internal risk rating system which is applied to all commercial and commercial real estate credits. Management conducts periodic examinations which serve as an independent verification of the accuracy of the ratings assigned. Loan grades are based on different factors within the borrowing relationship: entity sales, debt service coverage, debt/total net worth, liquidity, balance sheet and income statement trends, management experience, business stability, financing structure of the deal, and financial reporting requirements. The underlying collateral is also rated based on the specific type of collateral and corresponding liquidity. The combination of the borrower and collateral risk ratings result in the final rating for the borrowing relationship. Descriptions of the Company's internal risk ratings as they relate to credit quality are as follows.

Pass. Pass assets are not impaired nor do they have any known deficiencies that could impact the quality of the asset.

Special mention. Assets identified as special mention possess credit deficiencies or potential weaknesses deserving management's close attention. Special mention assets have a potential weakness or pose an unwarranted financial risk that, if not corrected, could weaken the assets and increase risk in the future.

Substandard. Assets identified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well-defined weakness or weaknesses. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. For HELOC loans and other consumer loans, the Company evaluates credit quality based on the aging and status of payment activity and includes all non-performing loans.

Doubtful. Assets identified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of current existing facts, conditions and values, highly questionable and improbable. The possibility of a loss on a doubtful asset is high. However, due to important and reasonably specific pending factors, which may work to strengthen (or weaken) the asset, its classification as an estimated loss is deferred until its more exact status can be determined.

Commercial Credit Exposure	As of June 30, 2012			
	Commercial Real Estate	Commercial and Industrial	Commercial Lease Financing	Total Commercial

	(Dollars in thousands)			
Grade:				
Pass	$557,198	$560,307	$ 151,993	$1,269,498
Special mention/watch	270,820	8,344	7,115	286,279
Substandard	246,997	637	—	247,634
Total loans	$1,075,015	$569,288	$ 159,108	$1,803,411

Consumer Credit Exposure	As of June 30, 2012					
	Residential First Mortgage	Second Mortgage	Warehouse	HELOC	Other Consumer	Total
	(Dollars in thousands)					
Grade:						
Pass	$2,241,918	$108,500	$1,177,674	$192,165	$ 57,164	$3,777,421
Special mention/watch	577,321	12,787	83,463	1,937	166	675,674
Substandard	282,898	6,147	305	4,126	275	293,751
Total loans	$3,102,137	$127,434	$1,261,442	$198,228	$ 57,605	$4,746,846

Commercial Credit Exposure	As of December 31, 2011			
	Commercial Real Estate	Commercial and Industrial	Commercial Lease Financing	Total Commercial
	(Dollars in thousands)			
Grade:				
Pass	$702,641	$ 324,920	$114,509	$1,142,070
Special mention/watch	347,440	1,595	—	349,035
Substandard	192,853	2,364	—	195,217
Doubtful	35	—	—	35
Total loans	$1,242,969	$ 328,879	$114,509	$1,686,357

Consumer Credit Exposure	As of December 31, 2011					
	Residential First Mortgage	Second Mortgage	Warehouse	HELOC	Other Consumer	Total
	(Dollars in thousands)					
Grade:						
Pass	$3,430,894	$132,671	$1,173,591	$213,912	$ 67,002	$5,018,070
Substandard	318,927	6,241	307	8,074	611	334,160
Total loans	$3,749,821	$138,912	$1,173,898	$221,986	$ 67,613	$5,352,230

Note 8 – Pledged Assets

The Company has pledged certain securities and loans to collateralize lines of credit and/or borrowings with the Federal Reserve Bank of Chicago and the FHLB of Indianapolis and others. The following table details pledged asset by asset class, and the carrying value of pledged investments and the investments maturities.

	June 30, 2012		December 31, 2011	
	Carrying Value	Investment Maturities	Carrying Value	Investment Maturities
	(Dollars in thousands)			
Cash pledged for letter of credit	$14,555	—	$14,546	—
Cash pledged in conjunction with derivative activities	108,987	—	—	—
Securities classified as trading:				
U.S. Treasury bonds	86,430	2014	184,601	Various

Securities classified as available-for-sale:				
Non-agency collateralized mortgage obligation securities obligations	100,306	2036	110,328	2036
Loans:				
Residential first mortgage loans	4,099,154	Various	4,444,186	Various
Second mortgage loans	106,945	Various	128,113	Various
HELOC loans	174,602	Various	33,505	Various
Commercial loans	484,861	Various	504,579	Various
Loans repurchased with government guarantees	1,633,462	Various	1,741,857	Various
Totals	$6,809,302		$7,161,715	

Note 9 – Private-Label Securitization Activity

The Company previously participated in four private-label securitizations of financial assets involving two HELOC loan transactions and two second mortgage loan transactions. In each of these securitizations, the financial assets were derecognized by the Company upon transfer to the securitization trusts, which then issued and sold mortgage-backed securities to third party investors. The Company relinquished control over the loans at the time the financial assets were transferred to the securitization trusts and the Company recognized a gain on the sale of the transferred assets.

In December 2005 and December 2006, the Company participated in non-agency HELOC securitizations (the “FSTAR 2005-1 HELOC Securitization” and the "FSTAR 2006-2 HELOC Securitization," respectively) in the amount of $600.0 million and $302.2 million, respectively. As a result of these securitizations, the Company recorded assets of $26.1 million and $11.2 million in residual interests, respectively. The offered securities in the two HELOC securitizations were both guaranteed by Assured Guaranty Municipal Corp., formerly known as Financial Security Assurance Inc. ("Assured").

In April 2006, the Company completed a $400.0 million securitization transaction involving fixed second mortgage loans that the Company held at the time in its investment portfolio. The transaction was treated as a recharacterization of loans held for investment to mortgage-backed securities held to maturity and, therefore, no gain on sale was recorded. As of June 30, 2012, the Company still holds this mortgage securitization in available-for-sale investment securities.

In addition, in March 2007, the Company completed a $620.9 million non-agency securitization transaction involving closed-ended, fixed and adjustable rate second mortgage loans and recorded $22.6 million in residual interests and servicing assets. In June 2007, the Company completed a secondary closing for $98.2 million and recorded an additional $4.2 million in residual interests. The offered securities in the two second mortgage loan securitizations were both guaranteed by MBIA Insurance Corporation.

The Company has not engaged in any private-label securitization activity since 2007.

In connection with the four private-label securitizations, the Company's retained interests in the securitized mortgage loans and trusts, which generally consisted of residual interests, transferor's interests, and servicing assets. The residual interests represent the present value of future cash flows expected to be received by the Company. Residual interests are accounted for at fair value and are included as securities classified as trading in the Consolidated Statements of Financial Condition. Any gains or losses realized on the sale of such securities and any subsequent changes in unrealized gains and losses are reported in the Consolidated Statements of Operations. At June 30, 2012, the Company’s residual interests have been deemed to have no value and have been written off. The transferor’s interests represent draws on the HELOCs subsequent to them being sold to the trusts that were funded by the Bank rather than being purchased by the securitization trusts. The transferor's interest relating to the FSTAR 2006-2 HELOC Securitization has been fully reserved for and the FSTAR 2005-1 HELOC Securitization has been partially reserved for. The transferor’s interests are included in loans held-for-investment in the Consolidated Statements of Financial Condition. At June 30, 2012, the Company no longer serviced any of the loans that were sold to the private-label securitization trusts, and therefore had no servicing assets accounted for on an amortized cost method.

The following table sets forth certain characteristics of each of the HELOC securitizations at their inception and the current characteristics as of and for the six month period ended June 30, 2012.

HELOC Securitizations	2005-1 At Inception	2005-1 Current Levels	2006-2 At Inception	2006-2 Current Levels
	(Dollars in thousands)			
Number of loans	8,155	2,403	4,186	1,844
Aggregate principal balance	$600,000	$107,674	$302,182	$110,617
Average principal balance	$55	$45	$72	$60
Weighted average fully indexed interest rate	8.43 %	5.74 %	9.43 %	6.46 %
Weighted average original term	120 months	120 months	120 months	120 months
Weighted average remaining term	112 months	36 months	112 months	50 months
Weighted average original credit score	722	718	715	720

Transferor's Interests

Under the terms of the HELOC securitizations, the trusts have purchased and were initially obligated to pay for any subsequent additional draws on the lines of credit transferred to the trusts. Upon entering a rapid amortization period, the Company becomes obligated to fund the purchase of those additional balances as they arise in exchange for a beneficial interest in the trust (transferor's interest). The Company must continue to fund the required purchase of additional draws by the trust as long as the securitization remains active. The table below identifies the draw contributions for each of the HELOC securitization trusts as well as the fair value of the transferor's interests.

Summary of Transferor's Interest by Securitization	June 30, 2012 FSTAR 2005-1	June 30, 2012 FSTAR 2006-2	December 31, 2011 FSTAR 2005-1	December 31, 2011 FSTAR 2006-2
	(Dollars in thousands)			
Total draw contribution	$35,591	$51,297	$35,430	$51,265
Additional balance increase amount (1)	$25,949	$28,868	$26,567	$29,964
Transferor's interest ownership percentage	23.38 %	25.53 %	22.18 %	24.49 %
Fair value of transferor's interests	$7,660	$—	$9,594	$—
Transferor's interest reserve	$301	$147	$309	$643

(1) Additional draws on lines of credit for which the Company receives a beneficial interest in the Trust.

FSTAR 2005-1 HELOC Securitization. At June 30, 2012 and December 31, 2011, outstanding claims due to the note insurer were $15.6 million and $14.4 million, respectively, and based on the Company's internal model, the Company believed that because of the claims due to the note insurer and continuing credit losses on the loans underlying the securitization, the fair value/carrying amount of the transferor's interest was $7.7 million and $9.6 million, respectively. The Company recorded a liability to reflect the expected liability arising from losses on future draws associated with this securitization, of which $0.3 million remained at June 30, 2012. In determining this liability, the Company assumed (i) no further draws would be made with respect to those HELOCs as to which further draws were currently prohibited, (ii) the remaining HELOCs would continue to operate in the same manner as their historical draw behavior indicated, as measured on an individual loan basis and on a pool drawdown basis, and (iii) that any draws actually made and therefore recognized as transferor's interests by the Company would have a loss rate of 70.5 percent.

FSTAR 2006-2 HELOC Securitization. At June 30, 2012 and December 31, 2011, outstanding claims due to the note insurer were $86.3 million and $82.7 million, respectively, and based on the Company's internal model, the Company believed that because of the claims due to the note insurer and continuing credit losses on the loans underlying the securitization, there was no carrying amount of the transferor's interest. The Company recorded a liability of $7.6 million to reflect the expected liability arising from losses on future draws associated with this securitization, of which $0.1 million remained at June 30, 2012. In determining this liability, the Company (i) assumed no further draws would be made with respect to those HELOCs as to which further draws were currently prohibited, (ii) the remaining HELOCs would continue to operate in the same manner as their historical draw behavior indicated, as measured on an

individual loan basis and on a pool drawdown basis, and (iii) that any draws actually made and therefore recognized as transferor's interests by the Company would have a loss rate of 100 percent.

The following table outlines the Company's expected losses on future draws on loans in FSTAR 2005-1 and FSTAR 2006-2 at June 30, 2012.

	Unfunded Commitments (1)	Expected Future Draws as % of Unfunded Commitments (2)	Expected Future Draws (3)	Expected Loss (4)	Potential Future Liability (5)
	(Dollars in thousands)				
FSTAR 2005-1 HELOC Securitization	$3,089	14.5 %	$447	70.5 %	$315
FSTAR 2006-2 HELOC Securitization	526	27.9 %	147	100.0 %	147
Total	$3,615		$594		$462

(1) Unfunded commitments represent the amounts currently fundable at the dates indicated because the underlying borrowers' lines of credit are still active.
(2) Expected future draws on unfunded commitments represents the historical draw rate within the securitization.
(3) Expected future draws reflects unfunded commitments multiplied by expected future draws percentage.
(4) Expected losses represent an estimated reduction in carrying value of future draws.
(5) Potential future liability reflects expected future draws multiplied by expected losses.

Assured Litigation

In 2009 and 2010, the Bank received repurchase demands from Assured, with respect to HELOCs that were sold by the Bank in connection with the HELOC securitizations. Assured is the note insurer for each of the two HELOC securitizations completed by the Bank. The Bank provided detailed rebuttals to these demands. In April 2011, Assured filed a lawsuit against the Bank in the U.S. District Court for the Southern District of New York, alleging a breach of various loan level representations and warranties and seeking relief for breach of contract, as well as full indemnification and reimbursement of amounts that it had paid under the respective insurance policy (which amounts were estimated by Assured to be in excess of $80 million), plus interest and costs. Subsequently, the court dismissed Assured's claims for indemnification and reimbursement, but allowed the case to proceed on the breach of contract claims (limited to those related to enforcing the Bank's "cure or repurchase" obligations). The court also granted the Bank's motion for reconsideration requesting that damages, if any, be paid to the securitization trust as opposed to Assured, and held that the ruling on the Bank's argument with respect to damages is limited to its motion to dismiss, and therefore not meant to be the law of the case. The case was continued until October 2012.

Unfunded Commitments

The table below identifies separately for each HELOC securitization trust: (i) the notional amount of the total unfunded commitment under the Company's contractual arrangements, (ii) unfunded commitments that have been frozen or suspended because the borrowers do not currently meet the contractual requirements under their home equity line of credit with the Company, and (iii) the amount currently fundable because the underlying borrowers' lines of credit are still active.

	FSTAR 2005-1	FSTAR 2006-2	Total
June 30, 2012	(Dollars in thousands)		
Notional amount of unfunded commitments (1)	$32,640	$28,740	$61,380
Less: Frozen or suspended unfunded commitments	29,551	28,214	57,765
Unfunded commitments still active	3,089	526	3,615
December 31, 2011			
Notional amount of unfunded commitments (1)	$33,226	$31,257	$64,483
Less: Frozen or suspended unfunded commitments	29,454	29,667	59,121

Unfunded commitments still active	3,772	1,590	5,362

(1) The Company’s total potential funding obligation is dependent on both (a) borrower behavior (e.g., the amount of additional draws requested) and (b) the contractual draw period (remaining term) available to the borrowers. Because borrowers can make principal payments and restore the amounts available for draws and then borrow additional amounts as long as their lines of credit remain active, the funding obligation has no specific limitation and it is not possible to define the maximum funding obligation. However, the Company expects that the maturity dates of the FSTAR 2005-1 HELOC Securitization and the FSTAR 2006-2 HELOC Securitization pools will be reached in 2015 and 2017, respectively, and the Company’s exposure will be substantially mitigated at such times, based on prepayment speeds and losses in the cash flow forecast.

Credit Risk on Securitization

With respect to the issuance of private-label securitizations, the Company retains certain limited credit exposure in that it retains non-investment grade residual securities in addition to customary representations and warranties. The Company does not have credit exposure associated with non-performing loans in securitizations beyond its investment in retained interests in non-investment grade residuals and draws (transferor’s interests) on HELOCs that it funds and which are not reimbursed by the respective trust. The value of the Company’s transferor’s interests reflects the Company’s credit loss assumptions as applied to the underlying collateral pool. To the extent that actual credit losses exceed the assumptions, the value of the Company’s non-investment grade residual securities and unreimbursed draws will be diminished.

During the fourth quarter 2010, all servicing related to loans underlying the private-label securitizations (i.e., HELOC and second mortgage loans) was transferred to a third party servicer.

The following table summarizes the Company's consumer servicing portfolio and the balance of retained assets with credit exposure, which includes residential interests that are included as securities classified as trading and unreimbursed HELOC draws that are included in loans held-for-investment.

	June 30, 2012		December 31, 2011	
	Amount of Loans Serviced	Balance of Retained Assets With Credit Exposure	Amount of Loans Serviced	Balance of Retained Assets With Credit Exposure
	(Dollars in thousands)			
Private-Label securitizations	$—	$ 7,660	$—	$ 9,594

Note 10 – Mortgage Servicing Rights

The Company has obligations to service residential first mortgage loans. Prior to December 31, 2011, the Company had obligations to service consumer loans (HELOC and second mortgage loans) resulting from private-label securitization transactions. A description of these classes of servicing assets follows.

Residential MSRs. Servicing of residential first mortgage loans is a significant business activity of the Company. The Company recognizes MSR assets on residential first mortgage loans when it retains the obligation to service these loans upon sale. MSRs are subject to changes in value from, among other things, changes in interest rates, prepayments of the underlying loans and changes in credit quality of the underlying portfolio. The Company utilizes the fair value method for residential first MSRs. As such, the Company currently specifically hedges certain risks of fair value changes of MSRs using derivative instruments that are intended to change in value inversely to part or all of the changes in the components underlying the fair value of MSRs.

Changes in the carrying value of residential first mortgage MSRs, accounted for at fair value, were as follows.

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2012	2011	2012	2011
	(Dollars in thousands)			
Balance at beginning of period	$596,830	$635,122	$510,475	$580,299

Additions from loans sold with servicing retained	126,691	38,254	238,175	88,954
Reductions from bulk sales (1)	—	(47,135)	(18,202)	(47,135)
Changes in fair value due to:				
Payoffs (2)	(29,165)	(13,945)	(55,997)	(28,466)
All other changes in valuation inputs or assumptions (3)	(55,491)	(34,895)	(35,586)	(16,251)
Fair value of MSRs at end of period	$638,865	$577,401	$638,865	$577,401
Unpaid principal balance of residential first mortgage loans serviced for others	$76,192,099	$57,087,989	$76,192,099	$57,087,989

(1) Includes bulk sales related to underlying serviced loans totaling zero and $2.4 billion for the three and six months ended June 30, 2012, respectively, compared to $4.7 billion for both the three and six months ended June 30, 2011.
(2) Represents decrease in MSR value associated with loans that were paid-off during the period.
(3) Represents estimated MSR value change resulting primarily from market-driven changes in interest rates.

The fair value of residential MSRs is estimated using a valuation model that calculates the present value of estimated future net servicing cash flows, taking into consideration expected mortgage loan prepayment rates, discount rates, servicing costs, and other economic factors, which are determined based on current market conditions. The Company periodically obtains third-party valuations of its residential MSRs to assess the reasonableness of the fair value calculated by the valuation model.
The key economic assumptions used in determining the fair value of those MSRs capitalized during the three and six months ended June 30, 2012 and 2011 periods were as follows.

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2012	2011	2012	2011
Weighted-average life (in years)	6.1	6.8	6.1	6.5
Weighted-average constant prepayment rate	14.5%	14.9%	14.8%	15.8%
Weighted-average discount rate	7.1%	8.4%	7.0%	8.2%

The key economic assumptions reflected in the overall fair value of the entire portfolio of MSRs were as follows.

	June 30, 2012	December 31, 2011
Weighted-average life (in years)	5.0	4.5
Weighted-average constant prepayment rate	19.1%	21.6%
Weighted-average discount rate	7.4%	7.2%

Contractual servicing fees. Contractual servicing fees, including late fees and ancillary income, for each type of loan serviced are presented below. Contractual servicing fees are included within loan administration income on the Consolidated Statements of Operations.

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2012	2011	2012	2011
	(Dollars in thousands)			
Residential first mortgage	$50,610	$42,727	$98,937	$86,314
Other	133	35	306	68
Total	$50,743	$42,762	$99,243	$86,382

Note 11 – Derivative Financial Instruments

The Company follows the provisions of derivatives and hedging accounting guidance, which require it to recognize all derivative instruments on the Consolidated Statements of Financial Condition at fair value. The following derivative financial instruments were identified and recorded at fair value as of June 30, 2012 and December 31, 2011.

- Fannie Mae, Freddie Mac, Ginnie Mae and other forward loan sale contracts;
- Rate lock commitments;
- Interest rate swap agreements; and
- U.S. Treasury futures and options.

The Company hedges the risk of overall changes in fair value of loans held-for-sale and rate lock commitments generally by selling forward contracts on securities of Fannie Mae, Freddie Mac and Ginnie Mae. The forward contracts used to economically hedge the loan commitments are accounted for as non-designated hedges and naturally offset rate lock commitment mark-to-market gains and losses recognized as a component of gain on loan sale. The Company recognized a pre-tax gain of $17.0 million and $58.1 million for the three and six months ended June 30, 2012, respectively, compared to a pre-tax loss of $(6.5) million and $(47.5) million for the three and six months ended June 30, 2011, respectively, on hedging activity relating to loan commitments and loans held-for-sale. Additionally, the Company hedges the risk of overall changes in fair value of MSRs through the use of various derivatives including purchases of forward contracts on securities of Fannie Mae and Freddie Mac and the purchase/sale of U.S. Treasury futures contracts on U.S. Treasury futures contracts. These derivatives are accounted for as non-designated hedges against changes in the fair value of MSRs. The Company recognized a gain of $58.9 million and $56.2 million for the three and six months ended June 30, 2012, respectively, compared to a gain of $36.6 million and $28.2 million for the three and six months ended June 30, 2011, respectively, on MSR fair value hedging activities. The Company does not apply hedge accounting, as prescribed in ASC 815: Derivatives and Hedging to any derivatives.

The Company uses a combination of derivatives (U.S. Treasury futures, swap futures, and “to be announced” forwards) and certain trading securities to hedge the MSRs. For accounting purposes, these hedges represent economic hedges of the MSR asset with both the hedges and the MSR asset carried at fair value on the balance sheet. Certain hedging strategies that we use to manage our investment in MSRs may be ineffective to fully offset changes in the fair value of such asset due to changes in interest rates and market liquidity. As both the hedges and the MSR asset are carried at fair value on the balance sheet, any hedge ineffectiveness is recognized in current period earnings.
The Company writes and purchases interest rate swaps to accommodate the needs of customers requesting such services. Customer-initiated trading derivatives are used primarily to focus on providing derivative products to customers that enables them to manage interest rate risk exposure. Customer-initiated trading derivatives are tailored to meet the needs of the counterparties involved and, therefore, contain a greater degree of credit risk and liquidity risk than exchange-traded contracts, which have standardized terms and readily available price information. The Company mitigates most of the inherent market risk of customer-initiated interest rate swap contracts by taking offsetting positions. Market risk from unfavorable movements in interest rates is generally economically hedged by concurrently entering into offsetting derivative contracts. The offsetting derivative contracts have nearly identical notional values, terms and indices. These limits are established annually and reviewed quarterly. Interest rate swaps are agreements in which two parties periodically exchange fixed cash payments for variable payments based on a designated market rate or index, or variable payments based on two different rates or indices, applied to a specified notional amount until a stated maturity. The Company's swap agreements are structured such that variable payments are primarily based on LIBOR (one-month, three-month or six-month) or prime. These instruments are principally negotiated over-the-counter and are subject to credit risk, market risk and liquidity risk.

The Company had the following derivative financial instruments.

	Notional Amount	Fair Value	Expiration Dates
	(Dollars in thousands)		
June 30, 2012			
Assets (1)			
Mortgage servicing rights			
U.S. Treasury and agency futures / forwards	$12,300,000	$13,414	2012
Mortgage banking derivatives:			
Rate lock commitments	6,439,851	132,388	2012

Customer-initiated derivatives			
Interest rate swaps	58,646	4,938	Various
Total derivative assets	$18,798,497	$150,740	
Liabilities (2)			
Mortgage banking derivatives			
Forward agency and loan sales	$7,826,510	$46,294	2012
Customer-initiated derivatives			
Interest rate swaps	58,646	4,938	Various
Total derivative liabilities	$7,885,156	$51,232	
December 31, 2011			
Assets (1)			
Mortgage servicing rights			
U.S. Treasury and agency futures / forwards	$1,552,000	$12,678	2012
Mortgage banking derivatives			
Rate lock commitments	3,869,901	70,965	2012
Customer-initiated derivatives			
Interest rate swaps	32,360	3,296	Various
Total derivative assets	$5,454,261	$86,939	
Liabilities (2)			
Mortgage servicing rights			
U.S. Treasury and agency futures	$5,029,000	$42,978	2012
Customer-initiated derivatives			
Interest rate swaps	32,360	3,296	Various
Total derivative liabilities	$5,061,360	$46,274	

(1) Asset derivatives are included in “other assets” on the “Consolidated Statements of Financial Condition.”
(2) Liability derivatives are included in “other liabilities” on the “Consolidated Statements of Financial Condition.”
Customer–initiated derivatives. Fee income on customer-initiated trading derivatives are earned from entering into various transactions at the request of customer (customer-initiated contracts) interest rate swap contracts. Fair values of customer-initiated derivative financial instruments represent the net unrealized gains or losses on such contracts and are recorded in the Consolidated Statement of Financial Condition in “other assets” and “other liabilities.” Changes in fair value are recognized in “other non-interest income” on the Consolidated Statements of Income. There was no net gains (losses) recognized in income on customer-initiated derivative instruments for the three and six months ended June 30, 2012 and 2011, respectively.

Counterparty credit risk. The Bank is exposed to credit loss in the event of non-performance by the counterparties to its various derivative financial instruments. The Company manages this risk by selecting only well-established, financially strong counterparties, spreading the credit risk among such counterparties, and by placing contractual limits on the amount of unsecured credit risk from any single counterparty.

Note 12 – FHLB Advances

The portfolio of FHLB advances includes floating rate short-term adjustable advances and fixed rate term advances. The following is a breakdown of the advances outstanding.

	June 30, 2012			December 31, 2011		
	Amount	Weighted Average Rate		Amount	Weighted Average Rate	
	(Dollars in thousands)					
Short-term adjustable advances	$—	—	%	$553,000	0.40	%

Long-term fixed rate term advances	3,400,000	3.10	%	3,400,000	3.10	%
Total	$3,400,000	3.10	%	$3,953,000	2.72	%

The Company restructured $1.0 billion in FHLB advances during the third quarter 2011.

	For the Three Months Ended June 30,				For the Six Months Ended June 30,			
	2012		2011		2012		2011	
	(Dollars in thousands)							
Maximum outstanding at any month end	$3,691,000		$3,406,571		$3,770,000		$3,406,571	
Average balance	3,996,527		3,400,202		4,047,079		3,434,438	
Average remaining borrowing capacity	754,994		623,901		701,268		716,259	
Average interest rate	2.76	%	3.56	%	2.72	%	3.53	%

At June 30, 2012, the Company has the authority and approval from the FHLB to utilize a line of credit equal to $7.0 billion and the Company may access that line to the extent that collateral is provided. At June 30, 2012, the Company had available collateral sufficient to access $4.1 billion of the line and had $3.4 billion of advances outstanding. Pursuant to collateral agreements with the FHLB, advances can be collateralized by non-delinquent single-family residential first mortgage loans, loans repurchased with government guarantees, certain other loans and investment securities.

Note 13 – Long-Term Debt

The Company's long-term debt is comprised principally of junior subordinated notes which were issued in connection with the issuance of trust preferred securities. The following table presents the outstanding balance and related interest rates of the long-term debt as of the dates indicated.

	June 30, 2012			December 31, 2011		
	(Dollars in thousands)					
Junior Subordinated Notes						
Floating 3 Month LIBOR						
Plus 3.25% (1), matures 2032	$25,774	3.71	%	$25,774	3.82	%
Plus 3.25% (1), matures 2033	25,774	3.72	%	25,774	3.65	%
Plus 3.25% (1), matures 2033	25,780	3.72	%	25,780	3.83	%
Plus 2.00% (1), matures 2035	25,774	2.47	%	25,774	2.40	%
Plus 2.00% (1), matures 2035	25,774	2.47	%	25,774	2.40	%
Plus 1.75% (1), matures 2035	51,547	2.22	%	51,547	2.30	%
Plus 1.50% (1), matures 2035	25,774	1.97	%	25,774	1.90	%
Plus 1.45%, matures 2037	25,774	1.92	%	25,774	2.00	%
Plus 2.50%, matures 2037	15,464	2.97	%	15,464	3.05	%
Subtotal	$247,435			$247,435		
Other debt						
Fixed 7.00% due 2013	1,150			1,150		
Total long-term debt	$248,585			$248,585		

(1) The securities are currently callable by the Company.

Deferral of Interest Payments

Interest on all junior subordinated notes related to trust preferred securities is payable quarterly. Under these arrangements, the Company has the right to defer dividend payments to the trust preferred security holders for up to five years. On January 27, 2012, the Company exercised its contractual rights to defer interest payments with respect

to trust preferred securities. Under the terms of the related indentures, the Company may defer interest payments for up to 20 consecutive quarters without default or penalty. The Company believes it prudent capital stewardship to refrain from making further payments until its financial condition improves. These payments will be periodically evaluated and reinstated when appropriate, subject to the provisions of the Company's supervisory agreement with the Federal Reserve. Concurrently, the Company also exercised contractual rights to defer dividend payments with respect to preferred stock issued and outstanding in connection with participation in the TARP Capital Purchase Program, see Note 16 - Stockholders' Equity.

Note 14 - Representation and Warranty Reserve

The following table shows the activity in the representation and warranty reserve.

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2012	2011	2012	2011
	(Dollars in thousands)			
Balance, beginning of period,	$142,000	$79,400	$120,000	$79,400
Provision				
Charged to gain on sale for current loan sales	5,643	1,375	10,694	3,714
Charged to representation and warranty reserve - change in estimate	46,028	21,364	106,566	41,791
Total	51,671	22,739	117,260	45,505
Charge-offs, net	(32,671)	(22,739)	(76,260)	(45,505)
Balance, end of period	$161,000	$79,400	$161,000	$79,400

Reserve levels are a function of expected losses based on actual pending and expected claims and repurchase requests, historical experience and loan volume. To the extent actual outcomes differ from management estimates, additional provisions could be required that could adversely affect operations or financial position in future periods.

During late 2011 and throughout the first half of 2012, the Company continued to see an increase in demand request activity from mortgage investors. As a result of the increased demand request activity and communications with mortgage investors, the Company reviewed as part of the quarterly review of accounting estimates the representation and warranty reserve methodology to more effectively incorporate the most recent observable data and trends. This is consistent with the improved risk segmentation and qualitative analysis and modeling performed for other similar reserve estimates, and consistent with expectations of the Bank's primary regulator and the continuing evaluation of the performance dynamics within the mortgage industry. The Company's enhanced first quarter 2012 methodology and related model refines previous estimates by adding granularity to the model by segmenting the sold portfolio by vintage years and investor to assign assumptions specific to each segment. Key assumptions in the model include investor audits, demand requests, appeal loss rates, loss severity, and recoveries.

The increase in the overall reserve balance during the three and six months ended June 30, 2012 was primarily due to refinements in the estimation process as described above, consistent with a more conservative posture taken by the Bank's new primary regulator and a continuing evolution of the performance dynamics within the mortgage industry. In addition, the increase reflected both charge-offs of certain loans previously sold into the secondary market and expectations of continued elevated levels of repurchase requests from government sponsored entities ("GSEs").

The Company routinely obtains information from the GSEs regarding the historical trends of demand requests, and occasionally obtains information on anticipated future loan reviews and potential repurchase demand projections. The Company believes this information provides helpful but limited insight in anticipating GSE behavior, thus helping to better estimate future repurchase requests and validate representation and warranty assumptions. Estimating the balance of the representation and warranty reserve involves using assumptions regarding future repurchase request volumes, expected loss severity on these requests and claims appeal success rates. Notwithstanding the information

obtained from the GSEs, the assumptions used to estimate the representation and warranty reserve contain a level of uncertainty and risk that could have a material impact on the representation and warranty reserve balance if they differ from actual results. To assess the sensitivity of the representation and warranty reserve model to adverse changes, management periodically runs a sensitivity analysis using its reserve model by assuming hypothetical increases in the level of repurchase volume.

Note 15 – Warrant Liabilities

May Investors

In full satisfaction of the Company's obligations under anti-dilution provisions applicable to certain investors (the "May Investors") in the Company's May 2008 private placement capital raise, the Company granted warrants (the "May Investor Warrants") to the May Investors on January 30, 2009 for the purchase of 1,425,979 shares of Common Stock at $6.20 per share. The holders of such warrants are entitled to acquire shares of Common Stock for a period of ten years. During 2009, May Investors exercised May Investor Warrants to purchase 314,839 shares of Common Stock.
As a result of the Company's registered offering on March 31, 2010, of 57.5 million shares of Common Stock at a price per share of $5.00, the number of shares of the Company's Common Stock issuable to the May Investors under the May Investor Warrants was increased by 266,674 and the exercise price was decreased to $5.00 pursuant to the antidilution provisions of the May Investors Warrants. As a result of the Company's registered offering on November 2, 2010 of 115.7 million shares of Common Stock at a price per share of $1.00, the number of shares of Common Stock issuable to the May Investors under the May Investor Warrants was increased by 5,511,255 and the exercise price was decreased to $1.00 pursuant to the antidilution provisions of the May Investors Warrants. For the six months ended June 30, 2012, no shares of Common Stock were issued upon exercise of May Investor Warrants, and at June 30, 2012, the May Investors held warrants to purchase 6,889,069 shares at an exercise price of $1.00.
Management believes the May Investor Warrants do not meet the definition of a contract that is indexed to the Company's own stock under U.S. GAAP. Therefore, the May Investor Warrants are classified as liabilities rather than as an equity instrument and are measured at fair value, with changes in fair value recognized through operations.
On January 30, 2009, in conjunction with the capital investments, the Company recorded the May Investor Warrants at their fair value of $6.1 million. From the issuance of the May Investor Warrants on January 30, 2009 through June 30, 2012, the Company marked these warrants to market which resulted in a increase in the liability during this time of $1.7 million for the six months ended June 30, 2012. This increase was recorded as warrant income included in non-interest expense.
At June 30, 2012, the Company's liabilities to the holders of May Investor Warrants amounted to $4.4 million. The warrant liabilities are included in "other liabilities" in the Consolidated Statements of Financial Condition.

Treasury Warrants

On January 30, 2009, the Company sold to the U.S. Treasury 266,657 shares of Series C fixed rate cumulative non-convertible perpetual preferred stock ("Series C Preferred Stock") and a warrant to purchase up to approximately 6.5 million shares of Common Stock at an exercise price of $6.20 per share (the "Treasury Warrant") for $266.7 million.
The issuance and the sale of the Series C Preferred Stock and Treasury Warrant were exempt from the registration requirements of the Securities Act of 1933, as amended. The Series C Preferred Stock qualifies as Tier 1 capital and pays cumulative dividends quarterly at a rate of 5 percent per annum for the first five years, and 9 percent per annum thereafter. The Treasury Warrant became exercisable upon receipt of stockholder approval on May 26, 2009 and has a ten-year term.
The Company did not have available an adequate number of authorized and unissued shares of the Common Stock, therefore, during the first quarter 2009, the Company recorded a Treasury Warrant liability that arose in conjunction with the Company's participation in the TARP Capital Purchase Program. As described in Note 15 - Stockholders' Equity, the Company initially recorded the Treasury Warrant on January 30, 2009 at its fair value of $27.7 million.
The Treasury Warrant was marked to market on March 31, 2009 resulting in an increase to the warrant liability of $9.1 million. Upon stockholder approval on May 26, 2009 to increase the number of authorized shares of Common Stock, the Company marked the liability to market at that date and reclassified the Treasury Warrant liability to additional paid in capital. The mark to market adjustment on May 26, 2009 resulted in an increase to the warrant liability of $12.9 million during the second quarter 2009. This increase was recorded as warrant expense and included in non-interest expense.

Note 16 – Stockholders' Equity

Preferred Stock

Preferred stock with a par value of $0.01 and a liquidation value of $1,000 and additional paid in capital attributable to preferred stock at June 30, 2012 is summarized as follows.

	Rate	Earliest Redemption Date	Shares Outstanding	Preferred Shares	Additional Paid in Capital
	(Dollars in thousands)				
Series C Preferred Stock	5.0 %	January 31, 2012	266,657	$3	$257,553

See Note 15 - Warrant Liabilities, for further information regarding the Series C Preferred Stock.

Deferral of Dividend Payments

On January 27, 2012, the Company provided notice to the U.S. Treasury exercising the contractual right to defer regularly scheduled quarterly payments of dividends, beginning with the February 2012 payment, on preferred stock issued and outstanding in connection with participation in the TARP Capital Purchase Program. Under the terms of the preferred stock, the Company may defer payments of dividends for up to six quarters in total without default or penalty. Concurrently, the Company also exercised contractual rights to defer interest payments with respect to trust preferred securities. See Note 13 - Long-Term Debt.

Accumulated Other Comprehensive Gain (Loss)

The following table sets forth the components in accumulated other comprehensive gain (loss) for each type of available-for-sale security.

	Pre-tax Amount	Income Tax (Expense) Benefit (1)	After-Tax Amount
	(Dollars in thousands)		
Accumulated other comprehensive gain (loss)			
Net unrealized gain (loss) on securities available-for-sale, June 30, 2012:			
Non-agency collateralized mortgage obligations	$31,819	$(20,608)	$11,211
U.S. government sponsored agency securities	1,459	728	2,187
FSTAR 2006-1 securitization trust	984	(6,108)	(5,124)
Total net unrealized gain (loss) on securities available-for-sale	$34,262	$(25,988)	$8,274
Net unrealized gain (loss) on securities available-for-sale, December 31, 2011:			
Non-agency collateralized mortgage obligations	$18,121	$(20,608)	$(2,487)
U.S. government sponsored agency securities	755	728	1,483
FSTAR 2006-1 securitization trust	(707)	(6,108)	(6,815)
Total net unrealized gain (loss) on securities available-for-sale	$18,169	$(25,988)	$(7,819)

(1) The income tax (expense) benefit reflects the amount which existed at the time the Company established the valuation allowance for deferred securities that were held at the date disposed or matured.

Note 17 – Earnings (Loss) Per Share

Basic earnings (loss) per share excludes dilution and is computed by dividing earnings (loss) available to common stockholders by the weighted average number of shares of Common Stock outstanding during the period. Diluted earnings (loss) per share reflects the potential dilution that could occur if securities or other contracts to issue Common Stock were exercised and converted into Common Stock or resulted in the issuance of Common Stock that

could then share in the earnings (loss) of the Company.

The following tables set forth the computation of basic and diluted earnings (loss) per share of Common Stock for the three and six months ended June 30, 2012 and 2011.

	For the Three Months Ended June 30, 2012			For the Three Months Ended June 30, 2011		
	(Dollars in thousands, except per share data)					
	Earnings	Weighted Average Shares	Per Share Amount	Loss	Weighted Average Shares	Per Share Amount
Net income (loss)	$87,387		$—	$(70,168)		$—
Less: preferred stock dividend/accretion	(1,417)		—	(4,720)		—
Basic earnings (loss) per share						
	85,970			(74,888)		
Deferred cumulative preferred stock dividends	(3,374)	—	—	—	—	—
Net income (loss) applicable to Common Stock	82,596	557,406	0.15	(74,888)	553,946	(0.14)
Effect of dilutive securities						
Warrants	—	—	—	—	—	—
Stock-based awards	—	4,415	—	—	—	—
Diluted earnings (loss) per share						
Net income (loss) applicable to Common Stock	$82,596	561,821	$0.15	$(74,888)	553,946	$(0.14)

Due to the loss attributable to common stockholders for the three months ended June 30, 2011, the diluted loss per share calculation excludes all common stock equivalents in the amount of 13,340,448 shares pertaining to warrants and 2,586,783 shares pertaining to stock-based awards. The inclusion of these securities would be anti-dilutive.

	For the Six Months Ended June 30, 2012			For the Six Months Ended June 30, 2011		
	(Dollars in thousands, except per share data)					
	Earnings	Weighted Average Shares	Per Share Amount	Loss	Weighted Average Shares	Per Share Amount
Net income (loss)	$80,077		$—	$(97,133)		$—
Less: preferred stock dividend/accretion	(2,824)		—	(9,429)		—
Basic earnings (loss) per share						
	77,253			(106,562)		
	(6,833)	—	—	—	—	—

Deferred cumulative preferred stock dividends						
Net income (loss) applicable to Common Stock	70,420	557,014	0.13	(106,562)	553,752	(0.19)
Effect of dilutive securities						
Warrants	—	—	—	—	—	—
Stock-based awards	—	3,068	—	—	—	—
Diluted earnings (loss) per share						
Net income (loss) applicable to Common Stock	$70,420	560,082	$0.13	$(106,562)	553,752	$(0.19)

Due to the loss attributable to common stockholders for the six months ended June 30, 2011, the diluted loss per share calculation excludes all common stock equivalents in the amount of 13,340,448 shares pertaining to warrants and 2,630,963 shares pertaining to stock-based awards. The inclusion of these securities would be anti-dilutive.

Note 18 – Compensation Plans

Stock-Based Compensation

For the three and six months ended June 30, 2012, the Company recorded stock-based compensation expense of $1.8 million and $3.5 million, respectively, compared to $1.9 million and $3.6 million for the three and six months ended June 30, 2011, respectively.

Incentive Compensation Plan

The Incentive Compensation Plans (“Incentive Plans”) are administered by the compensation committee of the Company's board of directors. The Incentive Plans include department specific plans, which include commercial lending, banking, underwriting and others, as well as a general incentive plan. Each year, the compensation committee decides which employees of the Company will be eligible to participate in the general incentive plan and the size of the bonus pool. During the three and six months ended June 30, 2012 and 2011, respectively, all eligible members of the executive management team were included in the general incentive plan. The Company incurred a $6.6 million and $13.6 million expense for the three and six months ended June 30, 2012, respectively, compared to expenses of $5.2 million and $9.1 million for the three and six months ended June 30, 2011, respectively.

Note 19 – Income Taxes

The Company periodically reviews the carrying amount of the deferred tax assets to determine if the establishment of a valuation allowance is necessary. If based on the available evidence, it is more likely than not that all or a portion of the deferred tax assets will not be realized in future periods, a deferred tax valuation allowance would be established. Consideration is given to all positive and negative evidence related to the realization of the deferred tax assets. In evaluating this available evidence, the Company considers historical financial performance, expectation of future earnings, the ability to carry back losses to recoup taxes previously paid, length of statutory carry forward periods, experience with operating loss and tax credit carry forwards not expiring unused, tax planning strategies and timing of reversals of temporary differences. Significant judgment is required in assessing future earning trends and the timing of reversals of temporary differences. The Company's evaluation is based on current tax laws as well as expectations of future performance.

The Company had cumulative pre-tax losses since 2007 and considered this factor in the analysis of deferred tax assets. Additionally, based on the continued economic uncertainty that persists at this time it was probable that the Company would not generate significant pre-tax income in the near term. As a result of these two significant facts, the Company established a valuation allowance on its deferred tax asset during the third quarter 2009. The Company’s net

deferred tax assets of $348.2 million and $383.8 million at June 30, 2012 and December 31, 2011, respectively, have been entirely offset by a valuation allowance. A valuation allowance is established when management determines that it is more likely than not that all or a portion of the Company’s net deferred tax assets will not be realized in future periods.

For the three months ended June 30, 2012, the net provision (benefit) for federal income taxes as a percentage of pretax income was 0.6 percent, compared to a provision (benefit) of 0.4 percent for the three months ended June 30, 2011. During the three months ended June 30, 2012, the variance to the statutory rate of 35 percent was attributable to a $31.2 million reduction to valuation allowance for net deferred tax assets, $0.7 million in unrealized holding gain on securities available-for-sale, certain non-deductible corporate expenses of $0.4 million, and non-deductible warrant income of $0.2 million. The variance to the statutory rate of 35 percent for the three months ended June 30, 2011 was attributable to a $25.0 million addition to valuation allowance for net deferred tax assets, certain non-deductible-corporate expenses of $0.4 million and non-deductible warrant income of $0.7 million.

For the six months ended June 30, 2012, the net provision (benefit) for federal income taxes as a percentage of pretax income was 0.6 percent, compared to a provision (benefit) of 0.5 percent for the six months ended June 30, 2011. During the six months ended June 30, 2012, the variance to the statutory rate of 35 percent was attributable to a $35.1 million reduction to the valuation allowance for net deferred tax assets, $5.6 million in unrealized holding gain on securities available-for-sale, certain non-deductible-corporate expenses of $1.1 million, and non-deductible warrant expense of $0.7 million. The variance to the statutory rate of 35 percent for the six months ended June 30, 2011 was attributable to a $34.5 million addition to the valuation allowance for net deferred tax assets, certain non-deductible-corporate expenses of $0.8 million and non-deductible warrant income of $1.0 million.

The Company's income tax returns are subject to examination by federal, state and local government authorities. On an ongoing basis, numerous federal, state and local examinations are in progress and cover multiple tax years. As of June 30, 2012, the Internal Revenue Service had completed its examination of the Company's income tax returns through the years ended December 31, 2008. The years open to examination by state and local government authorities vary by jurisdiction.

Note 20 – Legal Proceedings, Contingencies and Commitments

Legal Proceedings

The Company and certain subsidiaries are subject to various pending or threatened legal proceedings arising out of the normal course of business or operations. Although there can be no assurance as to the ultimate outcome of these proceedings, the Company, together with its subsidiaries, believes it has meritorious defenses to the claims presently asserted against it, including the matters described below. With respect to such legal proceedings, the Company intends to continue to defend itself vigorously, litigating or settling cases according to management's judgment as to the best interests of the Company and its shareholders.

On at least a quarterly basis, the Company assesses its liabilities and loss contingencies in connection with pending or threatened legal proceedings utilizing the latest information available. In accordance with ASC 450 (formerly SFAS 5), the Company establishes reserves for legal claims and regulatory matters when the Company believes it is probable that a loss may be incurred and that the amount of such loss can be reasonably estimated. Once established, accrued reserves are adjusted from time to time, as appropriate, in light of additional information.

Resolution of legal claims are inherently dependent on the specific facts and circumstances of each specific case, and therefore the actual costs of resolving these claims may be substantially higher or lower than the amounts reserved. Based on current knowledge, and after consultation with legal counsel, management believes that current reserves are adequate and the amount of any incremental liability that may otherwise arise is not expected to have a material adverse effect on the Company's consolidated financial condition or results of operations. Certain legal claims considered by the Company in its analysis of the sufficiency of its related reserves include the following:

Litigation settlement

On February 24, 2012, the Company announced that the Bank had entered into the DOJ Agreement relating to certain underwriting practices associated with loans insured by FHA. The Bank and the DOJ entered into the DOJ Agreement pursuant to which the Bank agreed to:

- comply with all applicable HUD and FHA rules related to the continued participation in the direct endorsement lender program;
- make an initial payment of $15.0 million within 30 business days of the effective date of the DOJ Agreement (which was paid on April 3, 2012);
- make the Additional Payments of approximately $118.0 million contingent only upon the occurrence of certain future events (as further described below); and
- complete a monitoring period by an independent third party chosen by the Bank and approved by HUD.

Subject to the Bank's full compliance with the terms of the DOJ Agreement, the DOJ, HUD, and FHA, agreed to:

- immediately release the Bank and all of its current or former officers, directors, employees, affiliates and assigns from any civil or administrative claim it has or may have under various federal laws, the common law or equitable theories of fraud or mistake of fact in connection with the mortgage loans the Bank endorsed for FHA insurance during the period January 1, 2002 to the date of the DOJ Agreement (the "Covered Period");
- not refuse to pay any insurance claim or seek indemnification or other relief in connection with the mortgage loans the Bank endorsed for FHA insurance during the Covered Period but for which no claims have yet been paid on the basis of the conduct alleged in the complaint or referenced in the DOJ Agreement; and
- not seek indemnification or other relief in connection with the mortgage loans the Bank endorsed for FHA insurance during the Covered Period and for which HUD has paid insurance claims on the basis of the conduct alleged in the complaint or referenced in the DOJ Agreement.

As of June 30, 2012, the Bank has accrued $19.1 million, which represents the fair value of the Additional Payments. See Note 3 - Fair Value Accounting, for further information on the DOJ litigation settlement. Other than as set forth above, the DOJ Agreement does not have any effect on FHA insured loans in our portfolio, including loans classified as loans repurchased with government guarantees as discussed in Note 6 - Loans Repurchased With Government Guarantees. The Company believes that such loans retain FHA insurance, and the Company continues to process such loans for insurance claims in the normal course

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and receive payments thereon from the FHA. Based on the experience subsequent to the Bank's agreement with the DOJ, the Company believes such claims are not subject to denial or dispute other than in the normal course of insurance claim processing.

ERISA Litigation

In February 2010, the Company was named as a defendant in a putative class action filed in the U.S. District Court alleging that it violated its fiduciary duty pursuant to the Employee Retirement Income Security Act ("ERISA") to employees who participated in the Company's 401(k) plan ("Plan") by continuing to offer Company stock as an investment option after investment in the stock allegedly ceased to be prudent. On July 16, 2010, the Company moved to dismiss the complaint and asserted, among other things, that the Plan's investment in employer stock was protected by a presumption of prudence under ERISA, and that plaintiff's allegations failed to overcome such presumption. On March 31, 2011, the court granted the Company's motion and dismissed the case. The plaintiffs appealed the matter to the U.S. Court of Appeals for the Sixth Circuit. On July 23, 2012, the Court of Appeals issued its ruling, reversing the district court's dismissal and remanding the case to the district court for further proceedings.

Mortgage-Related Litigation, Regulatory and Other Matters

Regulatory Matters

From time to time, governmental agencies conduct investigations or examinations of various mortgage related practices of the Bank. Currently, ongoing investigations relate to whether the Bank violated laws or regulations relating to mortgage origination or servicing practices and to whether its practices with regard to servicing residential first mortgage loans are adequate. The Bank is cooperating with such agencies and providing information as requested. In addition, the Bank has routinely been named in civil actions throughout the country by borrowers and former borrowers relating to the origination, purchase, sale and servicing of mortgage loans.

In March 2012, the Bank received a notice letter from HUD indicating that it was considering taking administrative action and imposing civil money penalties against the Bank related to certain alleged violations of HUD's servicing requirements. On July 19, 2012, HUD informally advised the Bank that it would be accepting its response to HUD's March 2012 letter, accepting the Company's response and proposed resolution.

Repurchase Demands and Indemnification Claims

In the normal course of its operations, the Bank receives repurchase and indemnification demands from counterparties involved with the purchase of residential first mortgages for alleged breaches of representations and warranties. The Bank establishes a representation and warranty reserve in connection with the estimated potential liability for such potential demands.

In 2009 and 2010, the Bank received repurchase demands from Assured, with respect to HELOCs that were sold by the Bank in connection with the HELOC securitizations. Assured is the note insurer for each of the two HELOC securitizations completed by the Bank. The Bank provided detailed rebuttals to these demands. In April 2011, Assured filed a lawsuit against the Bank in the U.S. District Court for the Southern District of New York, alleging a breach of various loan level representations and warranties and seeking relief for breach of contract, as well as full indemnification and reimbursement of amounts that it had paid under the respective insurance policy (which amounts were estimated by Assured to be in excess of $80 million), plus interest and costs. Subsequently, the court dismissed Assured's claims for indemnification and reimbursement, but allowed the case to proceed on the breach of contract claims (limited to those related to enforcing the Bank's "cure or repurchase" obligations). The court also granted the Bank's motion for reconsideration requesting that damages, if any, be paid to the securitization trust as opposed to Assured, and held that the ruling on the Bank's argument with respect to damages is limited to its motion to dismiss, and therefore not meant to be the law of the case. The case was continued until October 2012.

In May 2012, the Bank and Flagstar Reinsurance Company were named as defendants in a putative class action lawsuit filed in the United States District Court for the Eastern District of Pennsylvania, alleging a violation of Section 8 provisions of Real Estate Settlement Procedures Act ("RESPA"). Section 8 of RESPA generally prohibits anyone from accepting any fee or thing of value pursuant to any agreement or understanding that business related to a real estate settlement service involving a mortgage loan shall be referred to any person. Section 8 of RESPA also prohibits anyone from accepting any portion, split, or percentage of any charge made or received for the rendering of a real estate settlement service in connection with a mortgage loan other than for services actually performed. The lawsuit specifically alleges that the Bank and Flagstar Reinsurance Company violated Section 8 of RESPA through a captive reinsurance arrangement, involving allegedly illegal payments for the referral of private mortgage insurance business from private mortgage insurers to Flagstar Reinsurance Company, and Flagstar Reinsurance Company's purported receipt of an unlawful split of private mortgage insurance premiums. The Bank is in the beginning stages of evaluating the allegations in the complaint, but it intends to vigorously defend against such allegations.

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Accrued Reserves and Other Possible Contingent Liabilities

When establishing a reserve for contingent liabilities, the Company determines a range of potential losses for each matter that is probable to result in a loss and where the amount of the loss can be reasonably estimated. The Company then records the amount it considers to be the best estimate within the range. As of June 30, 2012, the Company's accrued reserve for contingent liabilities was $19.5 million. In addition, within the representation and warranty reserve, the Bank includes loans sold to certain non-agency securitization trusts. There may be further losses that could arise but the occurrence of which is not probable (but is reasonably possible) or the amount is not reasonably estimable, and therefore reserves for such amounts are not required to be accrued. The Company estimates that such further losses could amount up to $12.0 million in the aggregate. Notwithstanding the foregoing, in the event of unexpected future developments, it is possible that the ultimate resolution of those matters, if unfavorable, could result in a higher loss that, individually or in the aggregate, may be material to the Company's results of operations, or cash flows, for any particular period.

Contingencies and Commitments

A summary of the contractual amount of significant commitments is as follows.

	June 30, 2012	December 31, 2011
	(Dollars in thousands)	
Commitments to extend credit:		
Mortgage loans	$6,440,000	$3,870,000
HELOC trust commitments	61,000	64,000
Standby and commercial letters of credit	80,000	72,000

Commitments to extend credit are agreements to lend. Since many of these commitments expire without being drawn upon, the total commitment amounts do not necessarily represent future cash flow requirements. Certain lending commitments for mortgage loans to be sold in the secondary market are considered derivative instruments in accordance with accounting guidance ASC Topic 815, “Derivatives and Hedging”. Changes to the fair value of these commitments as a result of changes in interest rates are recorded on the Statements of Financial Condition as an other asset. The commitments related to mortgage loans are included in mortgage loans in the above table.
The Company enters into forward contracts for the future delivery or purchase of agency and loan sale contracts. These contracts are considered to be derivative instruments under U.S. GAAP. Further discussion on derivative instruments is included in Note 11 – Derivative Financial Instruments.
The Company has unfunded commitments under its contractual arrangement with the HELOC securitization trusts to fund future advances on the underlying home equity lines of credit. Refer to further discussion of this issue as presented in Note 9 – Private-label Securitization Activity.
Standby and commercial letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. Standby letters of credit generally are contingent upon the failure of the customer to perform according to the terms of the underlying contract with the third party, while commercial letters of credit are issued specifically to facilitate commerce and typically result in the commitment being drawn on when the underlying transaction is consummated between the customer and the third party.

The credit risk associated with loan commitments, standby and commercial letters of credit is essentially the same as that involved in extending loans to customers and is subject to normal credit policies. Collateral may be obtained based on management’s credit assessment of the customer. The guarantee liability for standby and commercial letters of credit was $1.4 million at June 30, 2012 and $8.2 million at December 31, 2011, respectively.

Note 21 – Segment Information

The Company's operations are generally conducted through two business segments: banking and home lending. Each business operates under the same banking charter but is reported on a segmented basis for this report. Each of the business lines is complementary to each other. The banking operation includes the gathering of deposits and investing those deposits in duration-matched assets primarily originated by the home lending operation. The banking group holds these loans in the investment portfolio in order to earn income based on the difference or "spread" between the interest earned on loans and the interest paid for deposits and other borrowed funds. The home lending operation involves the origination, packaging, and sale of loans in order to receive transaction income. The lending operation also services mortgage loans for others and sells MSRs into the secondary market. Funding for the lending operation is provided by deposits and borrowings garnered by the banking group. All of the non-bank consolidated subsidiaries are included in the banking segment. No such subsidiary is material to the Company's overall operations.

The following table presents financial information by business segment for the periods indicated.

	At or For the Three Months Ended June 30, 2012			
	Bank Operations	Home Lending Operations	Elimination	Combined
	(Dollars in thousands)			
Net interest income	$36,190	$39,288	$—	$75,478
Gain on sale revenue	20	215,394	—	215,414
Other (expense) income	12,397	12,523	—	24,920
Total net interest income and non-interest income	48,607	267,205	—	315,812
(Loss) income before federal income taxes	(66,323)	154,210	—	87,887
Depreciation and amortization	1,758	3,300	—	5,058
Capital expenditures	1,005	6,371	—	7,376
Inter-segment income (expense)	21,300	(21,300)	—	—
Identifiable assets	11,463,989	5,744,457	(2,840,000)	14,368,446

	At or For the Three Months Ended June 30, 2011			
	Bank Operations	Home Lending Operations	Elimination	Combined
	(Dollars in thousands)			
Net interest income	$57,534	$(6,210)	$—	$51,324
Gain on sale revenue	—	37,548	—	37,548
Other income (expense)	(2,312)	22,842	—	20,530
Total net interest income and non-interest income	55,222	54,180	—	109,402
(Loss) income before federal income taxes	(86,498)	16,594	—	(69,904)
Depreciation and amortization	1,440	2,084	—	3,524
Capital expenditures	588	13,821	—	14,409
Inter-segment income (expense)	24,255	(24,255)	—	—
Identifiable assets	10,951,437	4,945,375	(3,234,000)	12,662,812

	At or For the Six Months Ended June 30, 2012			
	Bank Operations	Home Lending Operations	Elimination	Combined
	(Dollars in thousands)			
Net interest income	$77,865	$72,346	$—	$150,211

Gain on sale revenue	330	411,959	—	412,289
Other (expense) income	28,985	20,436	—	49,421
Total net interest income and non-interest income	107,180	504,741	—	611,921
(Loss) income before federal income taxes	(177,864)	258,441	—	80,577
Depreciation and amortization	2,812	6,710	—	9,522
Capital expenditures	(4,748)	19,270	—	14,522
Inter-segment income (expense)	46,425	(46,425)	—	—
Identifiable assets	11,463,989	5,744,457	(2,840,000)	14,368,446

	At or For the Six Months Ended June 30, 2011			
	Bank Operations	Home Lending Operations	Elimination	Combined
	(Dollars in thousands)			
Net interest income	$90,721	$13,176	$—	$103,897
Gain on sale revenue	—	87,547	—	87,547
Other income (expense)	12,316	54,481	—	66,797
Total net interest income and non-interest income	103,037	155,204	—	258,241
(Loss) income before federal income taxes	(110,981)	14,376	—	(96,605)
Depreciation and amortization	2,970	4,196	—	7,166
Capital expenditures	687	18,765	—	19,452
Inter-segment income (expense)	46,943	(46,943)	—	—
Identifiable assets	10,951,437	4,945,375	(3,234,000)	12,662,812

Revenues are comprised of net interest income (before the provision for loan losses) and non-interest income. Non-interest expenses are fully allocated to each business segment. The intersegment income (expense) consists of interest expense incurred for intersegment borrowing.

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

Where we say "we," "us," or "our," we usually mean Flagstar Bancorp, Inc. However, in some cases, a reference to "we," "us," or "our" will include our wholly-owned subsidiary Flagstar Bank, FSB, and Flagstar Capital Markets Corporation ("FCMC"), its wholly-owned subsidiary, which we collectively refer to as the "Bank."

General

We are a Michigan based savings and loan holding company founded in 1993. Our business is primarily conducted through our principal subsidiary, the Bank, a federally chartered stock savings bank. At June 30, 2012, our total assets were $14.4 billion, making us the largest publicly held savings bank in the Midwest and one of the top 10 largest savings banks in the United States. We are considered a controlled company for New York Stock Exchange ("NYSE") purposes, because MP Thrift Investments, L.P. ("MP Thrift") held approximately 63.8 percent of our common stock as of June 30, 2012.

As a savings and loan holding company, we are subject to regulation, examination and supervision by the Board of Governors of the Federal Reserve (the "Federal Reserve"). The Bank is subject to regulation, examination and supervision by the Office of the Comptroller of the Currency ("OCC") of the United States Department of the Treasury ("U.S. Treasury"). The Bank is also subject to regulation, examination and supervision by the Federal Deposit Insurance Corporation ("FDIC") and the Bank's deposits are insured by the FDIC through the Deposit Insurance Fund ("DIF"). The Bank is also subject to the rule-making, supervision and examination authority of the Consumer Financial Protection Bureau (the "CFPB"), which is responsible for the principal federal consumer protection laws. The Bank is a member of the Federal Home Loan Bank ("FHLB") of Indianapolis.

At June 30, 2012, we operated 111 banking centers (of which 15 are located in retail stores), all located in Michigan. Of the 111 banking centers, 66 facilities are owned and 45 facilities are leased. During the second quarter 2012, two banking centers in Michigan were closed to better align the branch structure with the Company's focus on key market areas and to improve banking center efficiencies. Through our banking centers, we gather deposits and offer a line of

consumer and commercial financial products and services to individuals and businesses. We also gather deposits on a nationwide basis through our banking group, and provide deposit and cash management services to governmental units on a relationship basis. We leverage our banking centers and internet banking to cross-sell products to existing customers and increase our customer base. At June 30, 2012, we had a total of $8.9 billion in deposits, including $6.1 billion in retail deposits, $0.7 billion in government funds and $0.3 billion in wholesale deposits.

We also operate 30 loan origination centers located in 13 states, which originate one-to-four family residential first mortgage loans as part of our retail home lending business. These offices employ approximately 200 loan officers. We also originate retail loans through referrals from our 111 retail banking centers, consumer direct call center and our website, flagstar.com. Additionally, we have wholesale relationships with over 1,900 mortgage brokers and approximately 1,270 correspondents, which are located in all 50 states and serviced by 136 account executives. The combination of our retail, broker and correspondent channels gives us broad access to customers across diverse geographies to originate, fulfill, sell and service our residential first mortgage loan products. Our servicing activities primarily include collecting cash for principal, interest and escrow payments from borrowers, and accounting for and remitting principal and interest payments to investors and escrow payments to third parties.

Lastly, we operate a total of four commercial banking offices in Massachusetts, Connecticut, and Rhode Island, which were opened in 2011 as part of the Bank's plan to transform into a full-service and diversified super community bank. We believe that expanding our commercial banking division, and extending commercial lending to the New England region, will allow us to leverage our Personal Financial Services franchise, and that the commercial lending businesses will complement existing operations and contribute to the establishment of a diversified mix of revenue streams.

Our revenues include net interest income from our personal financial services and commercial banking activities, fee based income from services we provide customers, and non-interest income from sales of residential first mortgage loans to the secondary market, the servicing of loans for others, and the sale of servicing rights related to mortgage loans serviced for others. Approximately 98 percent of our total loan originations during the six months ended June 30, 2012 represented mortgage loans that were collateralized by residential first mortgages on single-family residences and were eligible for sale through the government sponsored enterprises ("GSEs") and Ginnie Mae.

At June 30, 2012, we had 3,520 full-time equivalent salaried employees of which 336 were account executives and loan officers.

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Operating Segments

Our business is comprised of two operating segments: banking and home lending. Our banking operation currently offers a line of consumer and commercial financial products and services to individuals, small and middle market businesses and large corporate borrowers. Our home lending operation originates, acquires, sells and services mortgage loans on family residences. Each operating segment supports and complements the operations of the other, with funding for the home lending operation primarily provided by deposits and borrowings obtained through the banking operation. Financial information regarding the two operating segments is set forth in Note 21 of the Notes to the Consolidated Financial Statements, in Item 1. Financial Statements and Supplementary Data. A discussion of our two operating segments is set forth below.

Bank Operations

Our bank operation is primarily used to gather deposits, which are used to fund the Bank's loan portfolios and other interest-earning assets. We gather deposits through three delivery channels: Personal Financial Services, Government Banking and Business / Commercial Banking.

- Personal Financial Services consists of Branch Banking and Internet Banking. At June 30, 2012, Branch Banking included 111 banking centers located throughout Michigan.

- Government Banking provides deposit and cash management services to government units on a relationship basis throughout Michigan and Georgia. Government banking manages relationships with various small and large government entities and school districts.

- Business / Commercial Banking engages in deposit gathering through our teams of business and commercial banking relationship managers.

Our banking operation may also borrow funds by obtaining advances from the FHLB or other federally backed institutions or by entering into repurchase agreements with correspondent banks using investments as collateral.

In addition to deposit gathering, as part of the transformation to a diversified full-service bank, our bank operation provides credit products to small, middle market and large corporate businesses, as well as offers consumer loans, investment and insurance products, and treasury management products and services.

Home Lending Operations

Our home lending operation originates, acquires, sells and services one-to-four family residential first mortgage loans. The origination or acquisition of residential first mortgage loans constitutes our most significant lending activity. At June 30, 2012, approximately 44.4 percent of interest-earning assets were held in residential first mortgage loans on single-family residences.

During 2011 and continuing into 2012, we were one of the country's leading mortgage loan originators. Three production channels were utilized to originate or acquire mortgage loans (Retail, Broker and Correspondent). Each production channel produces similar mortgage loan products and applies the same underwriting standards. We expect to continue to leverage technology to streamline the mortgage origination process and bring service and convenience to brokers and correspondents. Ten sales support offices were maintained that assist brokers and correspondents nationwide. We also continue to make increasing use of the Internet as a tool to facilitate the mortgage loan origination process through each of our production channels. Brokers, correspondents and retail home loan centers are able to register and lock loans, check the status of inventory, deliver documents in electronic format, generate closing

documents, and request funds through the Internet. Virtually all mortgage loans that closed in 2011 and continuing into 2012 utilized the Internet in the completion of the mortgage origination or acquisition process.

Retail. In a retail transaction, loans are originated through a nationwide network of stand alone home loan centers, as well as referrals from our retail banking centers and the national call center. When loans are originated on a retail basis, the origination documentation is completed inclusive of customer disclosures and other aspects of the lending process and funding of the transaction is completed internally. At June 30, 2012, we maintained 30 loan origination centers. At the same time, our centralized loan processing gained efficiencies and allowed lending staff to focus on originations. For the six months ended June 30, 2012, we closed $1.5 billion of loans utilizing this origination channel, which equaled 6.2 percent of total originations, compared to $0.7 billion or 7.2 percent of total originations during the six months ended June 30, 2011.

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Broker. In a broker transaction, an unaffiliated bank or mortgage brokerage company completes the loan paperwork, but the loans are underwritten on a loan-level basis to our underwriting standards and we supply the funding for the loan at closing (also known as "table funding") thereby becoming the lender of record. Currently, we have active broker relationships with over 1,900 banks or mortgage brokerage companies located in all 50 states. For the six months ended June 30, 2012, we closed loans totaling $6.1 billion utilizing this origination channel, which equaled 25.5 percent of total originations, compared to $2.8 billion or 29.1 percent during the six months ended June 30, 2011.

Correspondent. In a correspondent transaction, an unaffiliated mortgage company completes the loan paperwork and also supplies the funding for the loan at closing. After the mortgage company has funded the transaction, the loan is acquired, usually by us paying the mortgage company a market price for the loan. We do not acquire loans in "bulk" amounts from correspondents but rather we acquire each loan on a loan-level basis and each loan is required to be originated to our underwriting guidelines. We have active correspondent relationships with approximately 1,270 companies, including banks and mortgage companies, located in all 50 states. Over the years, we have developed a competitive advantage as a warehouse lender, wherein lines of credit to mortgage companies are provided to fund loans. We believe warehouse lending is not only a profitable, stand alone business for us, but also provides valuable synergies within our correspondent channel. We believe that offering warehouse lines has provided a competitive advantage in the small to midsize correspondent channel and has helped grow and build the correspondent business in a profitable manner. For example, for the six months ended June 30, 2012, warehouse lines funded over 65 percent of the loans in our correspondent channel. We plan to continue to leverage warehouse lending as a customer retention and acquisition tool throughout 2012. For the six months ended June 30, 2012, we closed loans totaling $16.2 billion utilizing the correspondent origination channel, which equaled 68.2 percent of total originations, compared to $6.0 billion or 63.7 percent originated during the six months ended June 30, 2011.

Underwriting

During the six months ended June 30, 2012, we primarily originated residential first mortgage loans for sale that conformed to the respective underwriting guidelines established by Fannie Mae, Freddie Mac and Ginnie Mae (each "an Agency" or collectively "the Agencies"). The increase in the held-for-investment loan portfolio was driven by our jumbo loan program offering in the third quarter 2011. The program has credit parameters, including maximum loan-to-value ("LTV") of 80 percent and a minimum FICO of 700, with a maximum loan limit of $2.0 million.

Residential first mortgage loans

At June 30, 2012, most of our held-for-investment residential first mortgage loans represented loans that were originated in 2009 or prior years with underwriting criteria that varied by product and with the standards in place at the time of origination.

Set forth below is a table describing the characteristics of the residential first mortgage loans in our held-for-investment portfolio at June 30, 2012, by year of origination.

Year of Origination	2008 and Prior	2009	2010	2011	2012	Total
	(Dollars in thousands)					
Unpaid principal balance [1]	$2,935,408	$63,007	$19,514	$25,566	$14,613	$3,058,108
Average note rate	4.30 %	5.04 %	4.99 %	4.52 %	4.07 %	4.32 %
Average original FICO score	713	693	711	743	762	713
Average current FICO score [2]	689	655	697	738	760	689
Average original loan-to-value ratio	75.8 %	85.2 %	77.0 %	78.8 %	71.4 %	76.0 %

Housing Price Index LTV, as recalculated (3)	95.3	%	92.7	%	83.8	%	79.7	%	71.5	%	94.9	%
Underwritten with low or stated income documentation	38.0	%	2.0	%	—	%	1.0	%	—	%	37.0	%

(1) Unpaid principal balance does not include premiums or discounts.
(2) Current FICO scores obtained at various times during the current quarter.
(3) The housing price index ("HPI") LTV is updated from the original LTV based on Metropolitan Statistical Area-level Office of Federal Housing Enterprise Oversight ("OFHEO") data as of March 31, 2012.

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Average original loan-to-value represents the loan balance at origination, as a percentage of the original appraised value of the property. Loan-to-values are refreshed quarterly based on estimates of home prices using the most current OFHEO data, and are reflective of a deterioration in housing prices as a result of the economic conditions over the last several years.

Residential first mortgage loans are underwritten on a loan by loan basis rather than on a pool basis. Generally, residential first mortgage loans produced through our production channels in the held-for-investment loan portfolio are reviewed by one of our in-house loan underwriters or by a contract underwriter. In all cases, loans must be underwritten to our underwriting standards.

Our criteria for underwriting generally includes, but are not limited to, full documentation of borrower income and other relevant financial information, fully indexed rate consideration for variable loans, and for agency loans, the specific agency's eligible loan to value ratios with full appraisals when required. Variances from any of these standards are permitted only to the extent allowable under the specific program requirements. These included the ability to originate loans with less than full documentation and variable rate loans with an initial interest rate less than the fully indexed rate. Mortgage loans are collateralized by a first or second mortgage on a one-to-four family residential property.

In general, for loans in the portfolio originated in years 2008 and prior, loan balances under $1,000,000 required a valid agency automated underwriting system (“AUS”) response for approval consideration. Documentation and ratio guidelines are driven by the AUS response. A FICO credit score for the borrower is required and a full appraisal of the underlying property that would serve as collateral is obtained.

For loan balances over $1,000,000, traditional manual underwriting documentation and ratio requirements are required as are two years plus year to date of income documentation and two months of bank statements. Income documentation based solely on a borrower's statement is an available underwriting option for each loan category. Even so, in these cases employment of the borrower is verified under the vast majority of loan programs, and income levels are usually checked against third party sources to confirm validity.

We believe that our underwriting process, which relies on the electronic submission of data and images and is based on an award winning imaging workflow process, allows for underwriting at a higher level of accuracy and with more timeliness than exists with processes which rely on paper submissions. We also provide our underwriters with integrated quality control tools, such as automated valuation models, multiple fraud detection engines and the ability to electronically submit IRS Form 4506 to ensure underwriters have the information that they need to make informed decisions. The process begins with the submission of an electronic application and an initial determination of eligibility. The application and required documents are then uploaded to our corporate underwriting department and all documents are identified by optical character recognition or our underwriting staff. The underwriter is responsible for checking the data integrity and reviewing credit. The file is then reviewed in accordance with the applicable guidelines established by us for the particular product. Quality control checks are performed by the underwriting department using the tools outlined above, as necessary, and a decision is then made and communicated to the prospective borrower.

The following table identifies our held-for-investment mortgages by major category, at June 30, 2012. Loans categorized as subprime were initially originated for sale and comprised only 0.1 percent of the portfolio of first liens.

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	Unpaid Principal Balance [1]	Average Note Rate	Average Original FICO Score	Average Current FICO Score [2]	Weighted Average Maturity	Average Original Loan-to-Value Ratio	Housing Price Index LTV, as recalculated [3]
	(Dollars in thousands)						
Residential first mortgage loans:							
Amortizing:							
3/1 ARM	$181,214	3.55 %	691	671	290	76.6 %	90.6 %
5/1 ARM	484,438	3.91 %	711	684	303	74.4 %	86.7 %
7/1 ARM	41,391	4.22 %	716	717	333	77.6 %	88.0 %
Other ARM	119,294	4.06 %	723	663	311	78.9 %	94.3 %
Fixed mortgage loans [4]	794,445	4.84 %	699	660	303	81.4 %	98.9 %
Interest only:							
3/1 ARM	232,478	3.83 %	723	707	278	73.1 %	93.6 %
5/1 ARM	825,469	3.88 %	725	714	281	73.7 %	92.5 %
7/1 ARM	57,604	5.90 %	725	717	302	73.9 %	105.4 %
Other ARM	39,832	4.42 %	733	716	277	71.7 %	98.4 %
Other interest only	214,250	5.87 %	723	700	293	74.8 %	105.7 %
Option ARMs	66,973	4.29 %	738	687	314	76.7 %	112.7 %
Subprime:							
3/1 ARM	50	10.30 %	685	687	280	91.2 %	73.8 %
Other ARM	247	9.93 %	648	646	285	84.8 %	110.1 %
Other subprime	423	8.71 %	523	612	294	71.2 %	92.7 %
Total residential first mortgage loans	$3,058,108	4.32 %	713	689	294	76.3 %	94.9 %
Second mortgage loans [5] [6]	$127,511	7.93 %	733	733	134	18.4 %	23.8 %
HELOC loans [5] [6]	$190,410	5.19 %	734	734	46	22.0 %	28.8 %

(1) Unpaid principal balance does not include premiums or discounts.
(2) Current FICO scores obtained at various times during the current quarter.
(3) The HPI LTV is updated from the original LTV based on Metropolitan Statistical Area-level OFHEO data as of March 31, 2012.
(4) Includes substantially fixed rate mortgage loans.
(5) Subprime loans are defined as the FDIC's assessment regulations definitions for subprime loans, which includes loans with FICO scores below 620 or similar characteristics.
(6) Reflects LTV because these are second liens.

The following table sets forth characteristics of those loans in our held-for-investment mortgage portfolio as of June 30, 2012 that were originated with less documentation than is currently required. Loans as to which underwriting information was accepted from a borrower without validating that particular item of information are referred to as “low doc” or “stated.” Substantially all of those loans were underwritten with verification of employment but with the related job income or personal assets, or both, stated by the borrower without verification of actual amount. Those loans may have additional elements of risk, because information provided by the borrower in connection with the loan was limited. Loans as to which underwriting information was supported by third party documentation or procedures are referred to as “full doc,” and the information therein is referred to as “verified.” Also set forth are different types of loans that may have a higher risk of non collection than other loans.

Explanation of Responses:

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June 30, 2012	Low Doc % of Held-for-Investment Portfolio		Unpaid Principal Balance (1)
	(Dollars in thousands)		
Characteristics:			
SISA (stated income, stated asset)	1.55	%	$101,312
SIVA (stated income, verified assets)	10.14	%	660,623
High LTV (i.e., at or above 95% at origination)	0.11	%	7,098
Second lien products (HELOCs, second mortgages)	1.42	%	92,346
Loan types:			
Option ARM loans	0.67	%	$43,455
Interest-only loans	7.83	%	510,362
Subprime (2)	0.01	%	352

(1) Unpaid principal balance does not include premiums or discounts.

(2) Subprime loans are defined as the FDIC's assessment regulations definitions for subprime loans, which includes loans with FICO scores below 620 or similar characteristics.

Adjustable-rate mortgages loans. Adjustable rate mortgage (“ARM”) loans held-for-investment were originated using Fannie Mae and Freddie Mac guidelines as a base framework, and the debt-to-income ratio guidelines and documentation typically followed the AUS guidelines. Our underwriting guidelines were designed with the intent to minimize layered risk.

At June 30, 2012, we had $67.0 million of option ARM loans in our held-for-investment loan portfolio. Option ARM loans permit a borrower to vary the monthly payment, including paying an amount that excludes interest otherwise due which is then added to the unpaid principal balance of the loan (a process referred to as “negative amortization”). The amount of negative amortization reflected in such loan balances for the six months ended June 30, 2012 was $4.7 million. The maximum balance that all option ARMs could reach cumulatively is $100.3 million at June 30, 2012.

Set forth below is a table describing the characteristics of our ARM loans in our held-for-investment mortgage portfolio at June 30, 2012, by year of origination.

Year of Origination	2008 and Prior		2009		2010		2011		2012		Total	
	(Dollars in thousands)											
Unpaid principal balance (1)	$1,998,862		$12,176		$8,545		$15,314		$14,093		$2,048,990	
Average note rate	3.94	%	4.72	%	4.60	%	4.31	%	4.07	%	3.95	%
Average original FICO score	715		676		723		744		764		716	
Average current FICO score (2)	698		649		712		738		762		699	
Average original loan-to-value ratio	75.6	%	85.8	%	68.9	%	74.4	%	70.6	%	75.6	%
Housing Price Index LTV, as recalculated (3)	92.5	%	98.9	%	79.4	%	74.1	%	70.9	%	92.2	%
Underwritten with low or stated income documentation	36.0	%	9.0	%	—	%	1.0	%	—	%	35.0	%

(1) Unpaid principal balance does not include premiums or discounts.
(2) Current FICO scores obtained at various times during the current quarter.
(3) The HPI LTV is updated from the original LTV based on Metropolitan Statistical Area-level OFHEO data as of March 31, 2012.

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Set forth below is a table describing specific characteristics of option power ARMs in our held-for-investment mortgage portfolio at June 30, 2012, which were originated in 2008 or prior.

Year of Origination	2008 and Prior (Dollars in thousands)	
Unpaid principal balance [(1)]	$66,973	
Average note rate	4.29	%
Average original FICO score	738	
Average current FICO score [(2)]	687	
Average original loan-to-value ratio	71.1	%
Average original combined loan-to-value ratio	79.8	%
Housing Price Index LTV, as recalculated [(3)]	112.7	%
Underwritten with low or stated income documentation	$43,455	
Total principal balance with any accumulated negative amortization	$48,711	
Percentage of total ARMS with any accumulated negative amortization	2.8	%
Amount of net negative amortization (i.e., deferred interest) accumulated as interest income during the six months ended June 30, 2012	$4,720	

(1) Unpaid principal balance does not include premiums or discounts.
(2) Current FICO scores obtained at various times during the current quarter.
(3) The HPI LTV is updated from the original LTV based on Metropolitan Statistical Area-level OFHEO data as of March 31, 2012.

Set forth below are the accumulated amounts of interest income arising from the net negative amortization portion of loans during the six months ended June 30, 2012 and 2011.

	Unpaid Principal Balance of Loans in Negative Amortization At Period End (1)	Amount of Net Negative Amortization Accumulated as Interest Income During Period
	(Dollars in thousands)	
2012	$48,711	$ 4,720
2011	$82,312	$ 7,916

(1) Unpaid principal balance does not include premiums or discounts.

Set forth below are the frequencies at which the ARM loans outstanding at June 30, 2012, will reprice.

Reset frequency	# of Loans	Balance	% of the Total	
	(Dollars in thousands)			
Monthly	120	$26,557	1.3	%
Semi-annually	3,323	999,195	49.0	%
Annually	2,709	407,309	20.0	%
No reset – non-performing loans	2,139	607,231	29.7	%
Total	8,291	$2,040,292	100.0	%

Set forth below as of June 30, 2012, are the amounts of the ARM loans in our held-for-investment loan portfolio with interest rate reset dates in the periods noted. As noted in the above table, loans may reset more than once over a three-year period and non-performing loans do not reset while in the non-performing status. Accordingly, the table below may include the same loans in more than one period.

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
	(Dollars in thousands)			
2012 (1)	N/A	N/A	$625,014	$641,228
2013	662,458	666,667	690,931	658,999
2014	685,477	699,159	741,999	675,158

Later years (2)	710,867	734,659	791,058	713,414

(1) Reflects loans that have reset through June 30, 2012.
(2) Later years reflect one reset period per loan.

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Interest only mortgages. Both adjustable and fixed term loans were offered with a 10-year interest only option. These loans were originated using Fannie Mae and Freddie Mac guidelines as a base framework. We generally applied the debt-to-income ratio guidelines and documentation using the AUS Approve/Reject response requirements.

Set forth below is a table describing the characteristics of the interest-only mortgage loans at the dates indicated in our held-for-investment mortgage portfolio at June 30, 2012, by year of origination.

Year of Origination	2008 and Prior		2009		2010		2011	2012	Total	
			(Dollars in thousands)							
Unpaid principal balance [1]	$1,367,615		$540		$1,478		N/A	N/A	$1,369,633	
Average note rate [2]	4.28	%	3.75	%	5.28	%	N/A	N/A	4.28	%
Average original FICO score	724		672		720		N/A	N/A	724	
Average current FICO score [3]	711		648		672		N/A	N/A	711	
Average original loan-to-value ratio	74.8	%	79.2	%	62.4	%	N/A	N/A	74.8	%
Housing Price Index LTV, as recalculated [4]	95.6	%	72.2	%	64.9	%	N/A	N/A	95.5	%
Underwritten with low or stated Income documentation	37.0	%	—	%	—	%	N/A	N/A	37.0	%

(1) Unpaid principal balance does not include premiums or discounts.

(2) As described earlier, interest only loans placed in portfolio in 2010 comprise loans that were initially originated for sale. There are two loans in this population.

(3) Current FICO scores obtained at various times during the current quarter.

(4) The HPI LTV is updated from the original LTV based on Metropolitan Statistical Area-level OFHEO data as of March 31, 2012.

Second mortgage loans. The majority of second mortgages we originated were closed in conjunction with the closing of the residential first mortgages originated by us. We generally required the same levels of documentation and ratios as with our residential first mortgages. For second mortgages closed in conjunction with a residential first mortgage loan that was not being originated by us, our allowable debt-to-income ratios for approval of the second mortgages were capped at 40 percent to 45 percent. In the case of a loan closing in which full documentation was required and the loan was being used to acquire the borrower's primary residence, we allowed a combined loan-to-value (“CLTV”) ratio of up to 100 percent; for similar loans that also contained higher risk elements, we limited the maximum CLTV to 90 percent. FICO floors ranged from 620 to 720, and fixed and adjustable rate loans were available with terms ranging from five to 20 years.

Set forth below is a table describing the characteristics of the second mortgage loans in our held-for-investment portfolio at June 30, 2012, by year of origination.

Year of Origination	2008 and prior		2009		2010		2011		2012		Total	
	(Dollars in thousands)											
Unpaid principal balance [1]	$125,512		$1,519		$392		$73		$15		$127,511	
Average note rate	7.95	%	6.92	%	6.87	%	7.33	%	6.99	%	7.93	%
Average original FICO score	733		716		694		706		741		733	
Average original loan-to-value ratio	20.2	%	18.0	%	14.5	%	14.9	%	15.0	%	18.4	%
Average original combined loan-to-value ratio	82.0	%	89.4	%	59.5	%	92.9	%	94.9	%	82.0	%

Housing Price Index LTV, as recalculated [2]	23.9 %	19.0 %	14.4 %	13.8 %	15.0 %	23.8 %

(1) Unpaid principal balance does not include premiums or discounts.
(2) The HPI LTV is updated from the original LTV based on Metropolitan Statistical Area-level OFHEO data as of March 31, 2012.

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Home Equity Line of Credit ("HELOC") loans. The majority of HELOC loans were closed in conjunction with the closing of related first mortgage loans originated and serviced by us. Documentation requirements for HELOC applications were generally the same as those required of borrowers for the first mortgage loans originated by us, and debt-to-income ratios were capped at 50 percent. For HELOCs closed in conjunction with the closing of a first mortgage loan that was not being originated by us, our debt-to-income ratio requirements were capped at 40 percent to 45 percent and the LTV was capped at 80 percent. The qualifying payment varied over time and included terms such as either 0.75 percent of the line amount or the interest only payment due on the full line based on the current rate plus 0.5 percent. HELOCs were available in conjunction with primary residence transactions that required full documentation, and the borrower was allowed a CLTV ratio of up to 100 percent. For similar loans that also contained higher risk elements, we limited the maximum CLTV to 90 percent. FICO floors ranged from 620 to 720. The HELOC terms called for monthly interest-only payments with a balloon principal payment due at the end of 10 years. At times, initial teaser rates were offered for the first three months.
Set forth below is a table describing the characteristics of the HELOCs in our held-for-investment portfolio at June 30, 2012, by year of origination.

Year of Origination	2008 and Prior	2009	2010	2011	2012	Total
	(Dollars in thousands)					
Unpaid principal balance [1]	$183,452	$697	N/A	$2,349	$3,912	$190,410
Average note rate [2]	5.23 %	5.65 %	N/A	3.90 %	3.79 %	5.19 %
Average original FICO score	733	—	N/A	758	768	734
Average original loan-to-value ratio	25.2 %	28.9 %	N/A	41.6 %	46.8 %	22.0 %
Housing Price Index LTV, as recalculated [3]	28.5 %	20.9 %	N/A	32.9 %	39.2 %	28.8 %

(1) Unpaid principal balance does not include premiums or discounts.
(2) Average note rate reflects the rate that is currently in effect. As these loans adjust on a monthly basis, the average note rate could increase, but would not decrease, as in the current market, the floor rate on virtually all of the loans is in effect.
(3) The HPI LTV is updated from the original LTV based on Metropolitan Statistical Area-level OFHEO data as of March 31, 2012.

Warehouse lending. We also continue to offer warehouse lines of credit to other mortgage lenders. These allow the lender to fund the closing of residential first mortgage loans. Each extension or drawdown on the line is collateralized by the residential first mortgage loan being funded, and in many cases, we subsequently acquire that loan. Underlying mortgage loans are predominately originated using GSE underwriting standards. These lines of credit are, in most cases, personally guaranteed by one or more qualified principal officers of the borrower. The aggregate amount of adjustable rate warehouse lines of credit granted to other mortgage lenders at June 30, 2012 was $2.3 billion, of which $1.3 billion was outstanding and had an average rate of 5.46 percent, compared to $2.1 billion granted at December 31, 2011, of which $1.2 billion was outstanding and had an average rate of 5.50 percent. As of June 30, 2012 and December 31, 2011, our warehouse lines funded over 65 percent of the loans in our correspondent channel. There were 308 warehouse lines of credit to other mortgage lenders with an average size of $7.4 million at June 30, 2012, compared to 293 warehouse lines of credit with an average size of $7.0 million at December 31, 2011. Loans on non-accrual status totaled $28,000 at both June 30, 2012 and December 31, 2011.

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Commercial Loans

In early 2011, we formally launched our commercial banking division, which includes origination of commercial real estate loans, middle market and small business lending, asset based lending and lease financing. This launch was subsequent to ceasing our origination of commercial real estate loans in 2008 using prior lending management and philosophies. See “Commercial real estate loans” below. By expanding commercial lending into the New England region, in addition to the team of commercial lenders in Michigan, management believes it can leverage the existing personal financial services network and banking franchise, providing a complement to existing operations and contributing to the establishment of a diversified mix of revenue streams.

In commercial lending, ongoing credit management is dependent upon the type and nature of the loan, and we monitor significant exposures on a regular basis. Internal risk ratings are assigned at the time of each loan approval and are assessed and updated with each monitoring event. The frequency of the monitoring event is dependent upon the size and complexity of the individual credit, but in no case less frequently than every 12 months. Current commercial real estate collateral values are updated more frequently if deemed necessary as a result of impairments of specific loan or other credit or borrower specific issues. We continually review and adjust our risk rating criteria and rating determination process based on actual experience. This review and analysis process also contributes to the determination of an appropriate allowance for loan loss amount for our commercial loan portfolio.

Our commercial loan portfolio totaled $1.8 billion at June 30, 2012 and $1.7 billion at December 31, 2011, and consists of three loan types, commercial real estate, commercial and industrial and commercial lease financing, each of which is discussed in more detail below. During the six months ended June 30, 2012, we originated $464.0 million in commercial loans. The following table identifies the commercial loan portfolio by loan type and selected criteria at June 30, 2012.

	Unpaid Principal Balance	Average Note Rate	Loans on Non-accrual Status
	(Dollars in thousands)		
Commercial real estate loans:			
Fixed rate	$720,214	5.45 %	$ 89,522
Adjustable rate	355,989	4.36 %	43,079
Total commercial real estate loans	1,076,203		$ 132,601
Net deferred fees and other	(1,188)		
Total commercial real estate loans	$1,075,015		
Commercial and industrial loans:			
Fixed rate	$83,627	3.52 %	$ 12
Adjustable rate	484,341	2.73 %	44
Total commercial and industrial loans	567,968		$ 56
Net deferred fees and other	1,320		
Total commercial and industrial loans	$569,288		
Commercial lease financing loans:			
Fixed rate	$157,040	4.05 %	$ —
Net deferred fees and other	2,068		
Total commercial lease financing loans	$159,108		

At June 30, 2012, our commercial real estate loan portfolio totaled $1.1 billion, or 16.4 percent of our investment loan portfolio, our commercial and industrial loan portfolio was $569.3 million, or 8.7 percent of our investment loan portfolio, and our commercial lease financing totaled $159.1 million, or 2.4 percent of our investment loan portfolio. At December 31, 2011, our commercial real estate loan portfolio totaled $1.2 billion, or 17.7 percent of our

investment loan portfolio, our commercial and industrial loan portfolio was $328.9 million, or 4.7 percent of our investment loan portfolio, and our commercial lease financing totaled $114.5 million, or 1.6 percent of our investment loan portfolio.

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The following table describes the unpaid principal balance of our commercial loan portfolio at June 30, 2012 by year of origination.

Year of Origination	2009 and Prior	2010	2011	2012	Total
	(Dollars in thousands)				
Commercial real estate loans [(1)]	$704,863	$22,806	$296,627	$51,907	$1,076,203
Commercial and industrial loans	1,507	753	291,260	274,448	567,968
Commercial lease financing loans	—	—	78,290	78,750	157,040

(1) During the six months ended June 30, 2012, we had no sales of non-performing commercial real estate loans and charged-off $77.9 million of the same loans.

At June 30, 2012, our total commercial loans were geographically concentrated, with approximately $517.6 million (28.7 percent) of unpaid principal balance on commercial loans located in Michigan, $304.5 million (16.9 percent) located in the New England region, $179.6 million (10.0 percent) located in New York, $126.5 million (7.0 percent) located in California, $114.2 million (6.3 percent) located in Texas and $95.3 million (5.3 percent) located in Georgia.

The average loan balance in our total commercial portfolio was approximately $1.5 million for the six months ended June 30, 2012, with the largest loan being $50.0 million. There are approximately 33 loans with more than $10.0 million of exposure and those loans comprised approximately 37.0 percent of the total commercial portfolio.

Commercial real estate loans. Our commercial real estate loan portfolio is comprised of loans that are collateralized by real estate properties intended to be income-producing in the normal course of business and consists of loans originated prior to 2011, including loans refinanced during 2009 and 2010 (“Legacy CRE”) and loans originated during 2011 and into 2012 (“New CRE”). We distinguish between Legacy CRE and New CRE portfolios given their respective differences in management objectives, performance and credit philosophy.

In early 2008, we ceased the origination of commercial real estate loans and made a decision to run-off the Legacy CRE portfolio. Since that time we replaced the previous commercial real estate management and loan officers with experienced workout officers and relationship managers. In addition, we prepared a comprehensive review, including customized workout plans for all classified loans, and risk assessments were prepared on a loan level basis for the entire commercial real estate portfolio. Legacy CRE loans are managed by our special assets group, whose primary objectives are working out troubled loans, reducing classified assets and taking pro-active steps to prevent deterioration in performing Legacy CRE loans.

In February 2011, we began originating New CRE loans under our new management team in our commercial banking area. The primary objective of this portfolio is to establish commercial banking relationships, which will add interest and fee income and provide us with cross-sell opportunities.

The following table sets forth the performance of the Legacy CRE and New CRE loan portfolios at June 30, 2012.

New CRE (1)

Property Type	30 Days Past Due	60 Days Past Due	90+ Days Past Due (2)	Balance	Total Reserves
	(Dollars in thousands)				
Construction one-to-four family	$—	$—	$—	$—	$—
Land	—	—	—	162	3
Commercial and industrial loans	—	—	—	3,580	60
One-to-four family conventional	—	—	—	464	8
Multi-family conventional	—	—	—	132,889	2,218
Commercial non-owner occupied	—	—	—	111,843	1,868

Secured by nonfarm, nonresidential	—	—	—	33,119	553
Other	—	—	—	47,906	800
Negative escrow	—	—	—	—	—
Net deferred fees and other	—	—	—	(1,802)	—
Total	$—	$—	$—	$328,161	$5,510

(1) Includes commercial real estate loans originated during 2011 and into 2012.

(2) Greater than 90 days past due includes performing non-accrual loans.

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Credit standards on the origination of New CRE loans are underwritten by experienced commercial real estate relationship manager's in each market, under much tighter policies and procedures than those of the Legacy CRE loans. In addition, our New CRE loans are originated by experienced commercial lenders, primarily in markets they understand well based on prior experience. The primary factors considered in commercial real estate credit approvals are the financial strength of the borrower, assessment of the borrower's management capabilities, industry sector trends, type of exposure, transaction structure, and the general economic outlook. Commercial real estate loans are made on a secured, or in limited cases, on an unsecured basis, with a vast majority also being refined by personal guarantees of the principals of the borrowing business. Assets used as collateral for secured commercial real estate loans required an appraised value sufficient to satisfy our LTV ratio requirements. We also generally require a minimum debt-service-coverage ratio, other than for development loans, and consider the enforceability and collectability of any relevant guarantees and the quality of the collateral.

Legacy CRE (1)

Property Type	30 Days Past Due	60 Days Past Due	90+ Days Past Due (2)	Balance	Total Reserves
	(Dollars in thousands)				
Construction one-to-four family	$—	$—	$1,027	$1,027	$—
Land	—	—	7,599	10,742	617
Commercial and industrial loans	—	—	—	—	—
One-to-four family conventional	72	—	672	3,315	288
Multi-family conventional	648	—	1,364	59,087	4,421
Commercial non-owner occupied	544	2,345	118,628	609,252	43,105
Secured by nonfarm, nonresidential	454	—	8,778	62,425	4,436
Other	—	—	—	394	30
Negative escrow	—	—	—	2,076	—
Net deferred fees and other	—	—	—	(1,463)	—
Total	$1,718	$2,345	$138,068	$746,855	$52,897

(1) Includes commercial real estate loans originated prior to 2011.
(2) Greater than 90 days past due includes performing non-accrual loans.

Commercial and industrial loans. Commercial and industrial loan facilities typically include lines of credit to our small or middle market businesses for use in normal business operations to finance working capital needs, equipment purchases and other expansion projects. We also participate, with other lenders, in syndicated deals to well known larger companies. Commercial and industrial loans include those loan facilities previously described, as well as asset based lending and auto dealer floor plan financing.

Commercial lease financing loans. Our commercial lease financing portfolio is comprised of equipment leased to customers in a direct financing lease. The net investment in financing leases includes the aggregate amount of lease payments to be received and the estimated residual values of the equipment, less unearned income. Income from lease financing is recognized over the lives of the leases on an approximate level rate of return on the unrecovered investment. The residual value represents the estimated fair value of the leased asset at the end of the lease term. Unguaranteed residual values of leased assets are reviewed at least annually for impairment. If any declines in residual values are determined to be other-than-temporary they will be recognized in earnings in the period such determinations are made.

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Summary of Operations

Our net income applicable to common stock for the three months ended June 30, 2012 was $86.0 million ($0.15 per diluted share), compared to a loss of $(74.9) million (loss of $(0.14) per diluted share) for the three months ended June 30, 2011. For the six months ended June 30, 2012, our net income applicable to common stock was $77.3 million ($0.13 per diluted share), as compared to a net loss of $(106.6) million (loss of $(0.19) per diluted share) during six months ended June 30, 2011. The increase during the six months ended June 30, 2012, compared to the six months ended June 30, 2011, was affected by the following factors:

- Net interest margin improved to 2.34 percent as compared to 1.81 percent for the six months ended June 30, 2011, primarily due to a decrease in our cost of funds;
- Net interest income increased by $46.3 million to $150.2 million for the six months ended June 30, 2012, primarily due to a 50 basis point decline in our cost of funds;
- Net gain on loan sales increased $327.5 million from the six months ended June 30, 2011, to $417.5 million, primarily due to an increase in volume of loan sales and margins;
- Representation and warranty reserve - change in estimate increased $64.8 million to $106.6 million for the six months ended June 30, 2012, primarily due to refinements in the estimation process that occurred during the first quarter 2012 and an increased demand of repurchase requests from GSEs; and
- Provision for loan losses increased by $96.4 million from the six months ended June 30, 2011, to $173.1 million, primarily as a result of refinements to existing loss models during the first quarter 2012.

See “Results of Operations” below.

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Selected Financial Ratios
(Dollars in thousands, except share data)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2012	2011	2012	2011
Return on average assets	2.37 %	(2.32)%	1.08 %	(1.64)%
Return on average equity	31.09 %	(24.87)%	13.78 %	(17.40)%
Efficiency ratio	53.7 %	119.7 %	58.5 %	107.7 %
Efficiency ratio (credit-adjusted) (1)	41.2 %	82.3 %	41.8 %	72.2 %
Equity/assets ratio (average for the period)	7.62 %	9.33 %	7.81 %	9.40 %
Mortgage loans originated (2)	$12,547,017	$4,642,864	$23,716,426	$9,499,248
Other loans originated	$203,584	$152,408	$475,029	$183,698
Mortgage loans sold and securitized	$12,777,311	$4,362,518	$23,607,109	$10,192,026
Interest rate spread – bank only(3)	2.10 %	1.62 %	2.12 %	1.62 %
Net interest margin – bank only(4)	2.37 %	1.86 %	2.39 %	1.87 %
Interest rate spread – consolidated(3)	2.08 %	1.61 %	2.10 %	1.61 %
Net interest margin – consolidated(4)	2.32 %	1.81 %	2.34 %	1.81 %
Average common shares outstanding	557,405,579	553,946,138	557,014,312	553,751,593
Average fully diluted shares outstanding	561,821,303	553,946,138	560,082,317	553,751,593
Average interest earning assets	$12,943,237	$11,297,984	$12,791,952	$11,385,031
Average interest paying liabilities	$11,100,307	$10,301,159	$11,047,283	$10,380,371
Average stockholders' equity	$1,106,224	$1,204,652	$1,121,421	$1,224,829
Charge-offs to average investment loans (annualized)	3.24 %	3.15 %	6.18 %	2.64 %

	June 30, 2012	December 31, 2011	June 30, 2011
Equity-to-assets ratio	8.20 %	7.92 %	9.27 %
Tier 1 capital ratio (to adjusted total assets)(5)	9.07 %	8.95 %	10.07 %
Total risk-based capital ratio (to risk-weighted assets) (5)	17.03 %	16.64 %	19.73 %
Book value per common share	$1.65	$1.48	$1.66
Number of common shares outstanding	557,722,618	555,775,639	554,163,337
Mortgage loans serviced for others	$76,192,099	$63,770,676	$57,087,989
Weighted average service fee (basis points)	30.4	30.8	30.3
Capitalized value of mortgage servicing rights	0.84 %	0.80 %	1.01 %
Ratio of allowance for loan losses to non-performing loans held-for-investment (5)	66.5 %	65.1 %	67.9 %
Ratio of allowance for loan losses to loans held-for-investment (6)	4.38 %	4.52 %	4.59 %
Ratio of non-performing assets to total assets (bank only)	3.75 %	4.43 %	4.06 %
Number of bank branches	111	113	162
Number of loan origination centers	30	27	30
Number of employees (excluding loan officers and account executives)	3,184	2,839	2,990
Number of loan officers and account executives	336	297	316

(1) Based on efficiency ratios as calculated, less representation and warranty reserve change in estimate and asset resolution expense.
(2) Includes residential first mortgage and second mortgage loans.
(3)

Interest rate spread is the difference between the annualized average yield earned on average interest-earning assets for the period and the annualized average rate of interest paid on average interest-bearing liabilities for the period.

(4) Net interest margin is the annualized effect of the net interest income divided by that period's average interest-earning assets.

(5) Based on adjusted total assets for purposes of tangible capital and core capital, and risk-weighted assets for purposes of risk-based capital and total risk-based capital. These ratios are applicable to the Bank only.

(6) Bank only and does not include non-performing loans held-for-sale.

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Results of Operations

Three months. Net income applicable to common stockholders for the three months ended June 30, 2012 was $86.0 million, $0.15 per diluted share, an $160.9 million increase from the loss of $(74.9) million, $(0.14) per diluted share, during the three months ended June 30, 2011. The increase in net income resulted from a $182.3 million increase in non-interest income, a $24.2 million increase in net interest income, offset by a $38.6 million increase in non-interest expense and a $10.0 million increase in provision for loan losses.

Six months. Net income applicable to common stockholders for the six months ended June 30, 2012 was $77.3 million, $0.13 per diluted share, a $183.8 million increase from the loss of $(106.6) million, $(0.19) per diluted share, during the six months ended June 30, 2011. The overall increase resulted from a $307.4 million increase in non-interest income and a $46.3 million increase in net interest income, offset by a $96.4 million increase in provision for loan losses and a $80.1 million increase in non-interest expense.

Net Interest Income

We recognized $75.5 million in net interest income for the three months ended June 30, 2012, which represented an increase of 47.1 percent, compared to $51.3 million reported for the three months ended June 30, 2011. The $24.2 million increase for three months ended June 30, 2012 is primarily due to a decrease in overall cost of funds to 1.72 percent from 2.21 percent in the three months ended June 30, 2011. Net interest income represented 23.9 percent of our total revenue during the three months ended June 30, 2012, compared to 46.9 percent for the three months ended June 30, 2011.

For the six months ended June 30, 2012, we recognized $150.2 million in net interest income, which represented an increase of 44.6 percent, compared to $103.9 million reported for the six months ended June 30, 2011. The $46.3 million increase for six months ended June 30, 2012, is primarily due to a decrease in overall cost of funds to 1.74 percent from 2.24 percent in the six months ended June 30, 2011. Net interest income represented 24.5 percent of our total revenue during the six months ended June 30, 2012, compared to 40.2 percent for the six months ended June 30, 2011.

Net interest income is primarily the dollar value of the average yield we earn on the average balances of our interest-earning assets, less the dollar value of the average cost of funds we incur on the average balances of our interest-bearing liabilities.

Three months. For the three months ended June 30, 2012, we had average interest-earning assets of $12.9 billion, compared to $11.3 billion for the three months ended June 30, 2011. The increase in average interest-earning assets reflects a $1.5 billion increase in average loans held-for-sale and a $0.7 billion increase in average loans held-for-investment. Average-interest bearing liabilities totaled $11.1 billion for the three months ended June 30, 2012, compared to $10.3 billion for the three months ended June 30, 2011. The increase of $0.8 billion reflects a $0.6 billion increase in average FHLB advances for the three months ended June 30, 2012, compared to the three months ended June 30, 2011.

The increase in interest income was primarily driven by an increase in the average balance of available-for-sale mortgage loans due to the increase in mortgage originations during the three months ended June 30, 2012, and an increase in commercial loans held-for-investment driven by new commercial relationships. Interest expense for the three months ended June 30, 2012 decreased compared to the three months ended June 30, 2011. We continue to replace maturing retail certificates of deposit with core money market and savings accounts. The average cost of interest-bearing liabilities decreased 49 basis points from 2.21 percent for the three months ended June 30, 2011 to 1.72 percent for the three months ended June 30, 2012, while the average yield on interest-earning assets slightly

decreased two basis points, from 3.82 percent for the three months ended June 30, 2011 to 3.80 percent for the three months ended June 30, 2012. As a result, our interest rate spread was 2.08 percent for the three months ended June 30, 2012, compared to 1.61 percent for the three months ended June 30, 2011.

Our consolidated net interest margin for the three months ended June 30, 2012 was 2.32 percent, compared to 1.81 percent for the three months ended June 30, 2011. The Bank recorded a net interest margin of 2.37 percent for the three months ended June 30, 2012, compared to 1.86 percent for the three months ended June 30, 2011.

Six months. For the six months ended June 30, 2012, we had average interest-earning assets of $12.8 billion, compared to $11.4 billion for the six months ended June 30, 2011. The increase in average interest-earning assets reflects a $1.1 billion increase in average loans available-for-sale and a $0.8 billion increase in average loans held-for-investment. Average-interest bearing liabilities totaled $11.0 billion for the six months ended June 30, 2012, compared to $10.4 billion for the six months ended June 30, 2011. The increase reflects a $0.6 billion increase in average FHLB advances for the six months ended June 30, 2012, compared to the six months ended June 30, 2011.

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Interest income for the six months ended June 30, 2012 was $245.8 million, an increase of 12.1 percent from the $219.2 million recorded for the six months ended June 30, 2011. The increase in interest income was primarily driven by an increase in the average balance of available-for-sale mortgage loans due to the increase in mortgage originations during the six months ended June 30, 2012, and an increase in commercial loans held-for-investment driven by new commercial relationships. Interest expense for the six months ended June 30, 2012 was $95.6 million, a 17.1 percent decrease, compared to $115.3 million for the six months ended June 30, 2011. We continue to replace maturing retail certificates of deposit with core money market and savings accounts. The average cost of interest-bearing liabilities decreased 50 basis points from 2.24 percent for the six months ended June 30, 2011 to 1.74 percent for the six months ended June 30, 2012, while the average yield on interest-earning assets decreased one basis point, from 3.85 percent for the six months ended June 30, 2011 to 3.84 percent for the six months ended June 30, 2012. As a result, our interest rate spread was 2.10 percent for the six months ended June 30, 2012, compared to 1.61 percent for the six months ended June 30, 2011.

Our consolidated net interest margin was positively impacted by the expansion of our interest rate spread during the six months ended June 30, 2012 . The result was a net interest margin for the six months ended June 30, 2012 of 2.34 percent, compared to 1.81 percent the six months ended June 30, 2011. The Bank recorded a net interest margin of 2.39 percent for the six months ended June 30, 2012, compared to 1.87 percent for the six months ended June 30, 2011.

On June 30, 2011, we implemented a reclassification in the treatment of amounts due from Federal Housing Administration (“FHA”) relating to the servicing of delinquent FHA loans to recognize the accrued credit from FHA as interest income. Previously, income from FHA was applied as an offset to non-interest expense (asset resolution expense) relating to the servicing of delinquent FHA loans, and recorded on a net basis as asset resolution expense. The impact of the reclassification on the three and six months ended June 30, 2011, was an increase in net interest income of $12.7 million and $25.5 million, respectively, with an offsetting increase to asset resolution expense and an increase in net interest margin of 20 basis points and 21 basis points, respectively.

The following tables present on a consolidated basis (rather than on a Bank-only basis) interest income from average earning assets, expressed in dollars and yields, and interest expense on average interest-bearing liabilities, expressed in dollars and rates. Interest income recorded on our loans is adjusted by the amortization of net premiums, net deferred loan origination costs and the amount of negative amortization (i.e., capitalized interest) arising from our option power ARM loans. These adjustments to interest income during the three and six months ended June 30, 2012 was a net reduction of $(0.1) million and $(2.1) million, respectively, compared to an increase of $0.5 million and a net reduction of $(0.4) million during the three and six months ended June 30, 2011, respectively. Non-accruing loans were included in the average loans outstanding.

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	For the Three Months Ended June 30,							
	2012				2011			
	Average Balance	Interest	Annualized Yield/ Rate		Average Balance	Interest	Annualized Yield/ Rate	
	(Dollars in thousands)							
Interest-Earning Assets:								
Loans held-for-sale	$2,977,233	$29,092	3.91	%	$1,509,692	$17,814	4.72	%
Loans repurchased with government guarantees	2,067,022	17,385	3.36	%	1,752,817	13,260	3.03	%
Loans held-for-investment:								
Consumer loans (1)	4,635,259	50,713	4.38	%	4,551,266	52,245	4.59	%
Commercial loans (1)	1,835,897	18,421	3.97	%	1,211,284	14,836	4.85	%
Loans held-for-investment	6,471,156	69,134	4.27	%	5,762,550	67,081	4.65	%
Securities classified as available-for-sale or trading	642,389	6,850	4.27	%	724,694	8,949	4.94	%
Interest-earning deposits and other	785,437	462	0.24	%	1,548,231	957	0.25	%
Total interest-earning assets	12,943,237	122,923	3.80	%	11,297,984	108,061	3.82	%
Other assets	1,571,239				1,612,293			
Total assets	$14,514,476				$12,910,277			
Interest-Bearing Liabilities:								
Demand deposits	$361,916	$219	0.24	%	$409,663	$339	0.33	%
Savings deposits	1,829,592	3,418	0.75	%	1,182,145	2,342	0.79	%
Money market deposits	482,296	588	0.49	%	579,361	1,061	0.73	%
Certificates of deposit	3,113,134	9,815	1.27	%	3,002,363	13,576	1.81	%
Total retail deposits	5,786,938	14,040	0.98	%	5,173,532	17,318	1.34	%
Demand deposits	95,805	117	0.49	%	66,549	91	0.55	%
Savings deposits	272,119	381	0.56	%	433,642	703	0.65	%
Certificates of deposit	361,315	595	0.66	%	237,600	397	0.67	%
Total government deposits	729,239	1,093	0.60	%	737,791	1,191	0.65	%
Wholesale deposits	339,018	3,188	3.78	%	741,024	6,393	3.46	%
Total deposits	6,855,195	18,321	1.07	%	6,652,347	24,902	1.50	%
FHLB advances	3,996,527	27,386	2.76	%	3,400,202	30,218	3.56	%
Other	248,585	1,738	2.81	%	248,610	1,617	2.61	%
Total interest-bearing liabilities	11,100,307	47,445	1.72	%	10,301,159	56,737	2.21	%
Other liabilities	2,307,945				1,404,466			
Stockholders' equity	1,106,224				1,204,652			
Total liabilities and stockholders equity	$14,514,476				$12,910,277			
Net interest-earning assets	$1,842,930				$996,825			
Net interest income		$75,478				$51,324		
Interest rate spread (2)			2.08	%			1.61	%
Net interest margin (3)			2.32	%			1.81	%
Ratio of average interest-earning assets to interest-bearing liabilities			116.6	%			109.7	%

(1) Consumer loans include: residential first mortgage, second mortgage, warehouse lending, HELOC and other consumer loans. Commercial loans include: commercial real estate, commercial and industrial, and commercial lease financing loans.

(2) Interest rate spread is the difference between rates of interest earned on interest-earning assets and rates of interest paid on interest-bearing liabilities.

(3) Net interest margin is net interest income divided by average interest-earning assets.

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	For the Six Months Ended June 30,							
	2012				2011			
	Average Balance	Interest	Annualized Yield/ Rate		Average Balance	Interest	Annualized Yield/ Rate	
	(Dollars in Thousands)							
Interest-Earning Assets:								
Loans held-for-sale	$2,685,479	$53,334	3.97	%	$1,596,272	$36,508	4.57	%
Loans repurchased with government guarantees	2,044,680	34,459	3.37	%	1,749,124	26,036	2.98	%
Loans held-for-investment:								
Consumer loans [(1)]	4,813,043	104,628	4.36	%	4,583,299	107,985	4.72	%
Commercial loans [(1)]	1,795,907	37,098	4.09	%	1,219,834	29,740	4.85	%
Loans held-for-investment	6,608,950	141,726	4.28	%	5,803,133	137,725	4.75	%
Securities classified as available-for-sale or trading	714,332	15,421	4.32	%	677,332	17,046	5.04	%
Interest-earning deposits and other	738,511	874	0.24	%	1,559,170	1,925	0.25	%
Total interest-earning assets	12,791,952	245,814	3.84	%	11,385,031	219,240	3.85	%
Other assets	1,568,874				1,638,684			
Total assets	$14,360,826				$13,023,715			
Interest-Bearing Liabilities:								
Demand deposits	$354,229	$441	0.25	%	$404,043	$724	0.36	%
Savings deposits	1,719,894	6,723	0.79	%	1,128,994	4,736	0.85	%
Money market deposits	484,602	1,236	0.51	%	567,737	2,135	0.76	%
Certificates of deposit	3,099,009	20,145	1.31	%	3,093,482	28,712	1.87	%
Total retail deposits	5,657,734	28,545	1.01	%	5,194,256	36,307	1.41	%
Demand deposits	97,265	239	0.49	%	72,117	195	0.55	%
Savings deposits	271,360	767	0.57	%	395,593	1,275	0.65	%
Certificates of deposit	376,985	1,243	0.66	%	244,584	825	0.68	%
Total government deposits	745,610	2,249	0.61	%	712,294	2,295	0.65	%
Wholesale deposits	348,275	6,514	3.76	%	790,772	13,322	3.40	%
Total Deposits	6,751,619	37,308	1.11	%	6,697,322	51,924	1.56	%
FHLB advances	4,047,079	54,778	2.72	%	3,434,438	60,196	3.53	%
Other	248,585	3,517	2.84	%	248,610	3,223	2.61	%
Total interest-bearing liabilities	11,047,283	95,603	1.74	%	10,380,370	115,343	2.24	%
Other liabilities	2,192,122				1,418,516			
Stockholders’ equity	1,121,421				1,224,829			
Total liabilities and stockholders equity	$14,360,826				$13,023,715			
Net interest-earning assets	$1,744,669				$1,004,661			
Net interest income		$150,211				$103,897		
Interest rate spread [(2)]			2.10	%			1.61	%
Net interest margin [(3)]			2.34	%			1.81	%
Ratio of average interest-earning assets to interest-bearing liabilities			115.8	%			109.7	%

(1) Consumer loans include: residential first mortgage, second mortgage, warehouse lending, HELOC and other consumer loans. Commercial loans include: commercial real estate, commercial and industrial, and commercial lease financing loans.

(2) Interest rate spread is the difference between rates of interest earned on interest-earning assets and rates of interest paid on interest-bearing liabilities.

(3) Net interest margin is net interest income divided by average interest-earning assets.

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Rate/Volume Analysis

The following tables present the dollar amount of changes in interest income and interest expense for the components of interest-earning assets and interest-bearing liabilities that are presented in the preceding table. The table below distinguishes between the changes related to average outstanding balances (changes in volume while holding the initial rate constant) and the changes related to average interest rates (changes in average rates while holding the initial balance constant). Changes attributable to both a change in volume and a change in rates were included as changes in rate.

	For the Three Months Ended June 30, 2012 Versus 2011 Increase (Decrease) Due to:		
	Rate	Volume	Total
	(Dollars in thousands)		
Interest-Earning Assets:			
Loans held-for-sale	$(6,039)	$17,317	$11,278
Loans repurchased with government guarantees	1,748	2,377	4,125
Loans held-for-investment			
Consumer loans[1]	(2,497)	965	(1,532)
Commercial loans[2]	(3,981)	7,566	3,585
Total loans held-for-investment	(6,478)	8,531	2,053
Securities available-for-sale or trading	(1,082)	(1,017)	(2,099)
Interest-earning deposits and other	(23)	(472)	(495)
Total other interest-earning assets	$(11,874)	$26,736	$14,862
Interest-Bearing Liabilities:			
Demand deposits	$(80)	$(40)	$(120)
Savings deposits	(210)	1,286	1,076
Money market deposits	(295)	(178)	(473)
Certificates of deposit	(4,263)	502	(3,761)
Total retail deposits	(4,848)	1,570	(3,278)
Demand deposits	(14)	40	26
Savings deposits	(60)	(262)	(322)
Certificates of deposit	(9)	207	198
Total government deposits	(83)	(15)	(98)
Wholesale deposits	273	(3,478)	(3,205)
Total deposits	(4,658)	(1,923)	(6,581)
FHLB advances	(8,146)	5,314	(2,832)
Other	121	—	121
Total interest-bearing liabilities	$(12,683)	$3,391	$(9,292)
Change in net interest income	$809	$23,345	$24,154

(1) Consumer loans include residential first mortgage, second mortgage, warehouse lending, HELOC and other consumer loans.

(2) Commercial loans include commercial real estate, commercial and industrial, and commercial lease financing loans.

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	For the Six Months Ended June 30, 2012 Versus 2011 Increase (Decrease) Due to:		
	Rate	Volume	Total
	(Dollars in thousands)		
Interest-Earning Assets:			
Loans held-for-sale	$(8,085)	$24,911	$16,826
Loans repurchased with government guarantees	4,024	4,399	8,423
Loans held-for-investment			
Consumer loans[1]	(8,778)	5,421	(3,357)
Commercial loans[2].	(6,609)	13,967	7,358
Total loans held-for-investment	(15,387)	19,388	4,001
Securities available-for-sale or trading	(2,557)	932	(1,625)
Interest-earning deposits and other	(30)	(1,021)	(1,051)
Total other interest-earning assets	$(22,035)	$48,609	$26,574
Interest-Bearing Liabilities:			
Demand deposits	$(193)	$(90)	$(283)
Savings deposits	(512)	2,499	1,987
Money market deposits	(584)	(315)	(899)
Certificates of deposit	(8,619)	52	(8,567)
Total retail deposits	(9,908)	2,146	(7,762)
Demand deposits	(25)	69	44
Savings deposits	(104)	(404)	(508)
Certificates of deposit	(32)	450	418
Total government deposits	(161)	115	(46)
Wholesale deposits	709	(7,517)	(6,808)
Total deposits	(9,360)	(5,256)	(14,616)
FHLB advances	(16,245)	10,827	(5,418)
Other	294	—	294
Total interest-bearing liabilities	$(25,311)	$5,571	$(19,740)
Change in net interest income	$3,276	$43,038	$46,314

(1) Consumer loans include residential first mortgage, second mortgage, warehouse lending, HELOC and other consumer loans.

(2) Commercial loans include commercial real estate, commercial and industrial, and commercial lease financing loans.

Provision for Loan Losses

The provision reflects our estimate to maintain the allowance for loan losses at a level to cover probable losses inherent in the portfolio for each of the respective periods.

Three months. The provision for loan losses was $58.4 million for the three months ended June 30, 2012, an increase from $48.4 million for the three months ended June 30, 2011. Loan loss provision expense increased for the three months ended June 30, 2012, as compared to the three months ended June 30, 2011, primarily due to the refinements to existing loss models adopted during the first quarter 2012. Net charge-offs for three months ended June 30, 2012 totaled $52.4 million, compared to $45.4 million for the three months ended June 30, 2011. As a percentage of the average loans held-for-investment, net charge-offs for the three months ended June 30, 2012 increased to 0.81 percent from 0.79 percent for the three months ended June 30, 2011. The increase in the provision coupled with an increase in

net charge-offs during the three months ended June 30, 2012, increased the allowance for loan losses to $287.0 million at June 30, 2012.

Six months. During the six months ended June 30, 2012, we recorded a provision for loan losses of $173.1 million as compared to $76.7 million recorded during the six months ended June 30, 2011. The increase in the provision during the six months ended June 30, 2012 resulted in an allowance for loan losses of $287.0 million at June 30, 2012 and $318.0 at December 31, 2011. Net charge-offs for six month period ended June 30, 2012 totaled $204.1 million, compared to $76.7 million during the six months

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ended June 30, 2011. The increase was primarily due to refinements in our loss models implemented in the first quarter 2012. As a percentage of the average loans held-for-investment, net charge-offs for the six months ended June 30, 2011 increased to 3.09 percent from 1.32 percent during the six months ended June 30, 2011.

Past due loans include all loans that were delinquent for at least 30 days when a borrower fails to make a payment and/or such payment is received after the first day of the month following the month of the missed payment. Total past due loans decreased to $522.5 million at June 30, 2012, of which $431.6 million were greater than 90 days past due, compared to $633.5 million at December 31, 2011, of which $488.4 million were greater than 90 days past due. During the six months ended June 30, 2012, the decrease in past due loans primarily resulted from charge offs of specific valuation allowances and successes in loan modification efforts. The overall past due loan rates on residential first mortgage loans decreased to 11.6 percent at June 30, 2012 from 12.9 percent at December 31, 2011. This decrease was driven largely by the residential first mortgage net charge offs during the six months ended June 30, 2011 of $110.9 million. The overall past due loan rates on commercial real estate loans increased to 13.2 percent at June 30, 2012 from 9.6 percent at December 31, 2011, due to some adverse migration to nonaccrual status.

See the section captioned “Allowance for Loan Losses” in this discussion for further analysis of the provision for loan losses.

Non-Interest Income

The following table sets forth the components of our non-interest income.

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2012	2011	2012	2011
	(Dollars in thousands)			
Loan fees and charges	$34,783	$14,712	$64,757	$30,850
Deposit fees and charges	5,039	7,845	9,961	15,345
Loan administration	25,012	30,450	63,898	69,786
Net gain (loss) on trading securities	3,711	102	(2,260)	28
Loss on transferors’ interest	(1,244)	(2,258)	(1,653)	(4,640)
Net gain on loan sales	212,666	39,827	417,518	90,012
Net loss on sales of mortgage servicing rights	(983)	(2,381)	(3,299)	(2,493)
Net gain on securities available-for-sale	20	—	330	—
Net (loss) gain on sale of assets	(26)	1,293	—	256
Total other-than-temporary impairment (loss) gain	(1,707)	39,725	2,810	39,725
Gain (loss) recognized in other comprehensive income before taxes	690	(55,309)	(5,002)	(55,309)
Net impairment losses recognized in earnings	(1,017)	(15,584)	(2,192)	(15,584)
Representation and warranty reserve – change in estimate	(46,028)	(21,364)	(106,566)	(41,791)
Other fees and charges	8,401	5,436	21,216	12,575
Total non-interest income	$240,334	$58,078	$461,710	$154,344

Total non-interest income was $240.3 million during the three months ended June 30, 2012, which was a $182.2 million increase from $58.1 million of non-interest income during the three months ended June 30, 2011. The increase during the three months ended June 30, 2012, was primarily due to an increase in net gain on loan sales, an increase in loan fees and charges and a decrease in loss recognized in other comprehensive income before taxes, offset in part by an increase in representation and warranty reserve - change in estimate. During the six months ended June 30, 2012, total non-interest income increased to $461.7 million, from $154.3 million of non-interest income during the six months ended June 30, 2011. The changes during the six months ended June 30, 2012, were primarily due to the same reasons stated above. Factors affecting the comparability of the primary components of non-interest income are discussed in the following paragraphs.

Loan fees and charges. Our lending operation and banking operation both earn loan origination fees and collect other charges in connection with originating residential first mortgages, commercial loans and other consumer loans. For the three months ended June 30, 2012, we recorded loan fees and charges of $34.8 million, an increase of $20.1 million from the $14.7 million recorded during the three months ended June 30, 2011. Loan fees and charges during the six months ended June 30, 2012

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were $64.8 million, compared to $30.9 million recorded during the six months ended June 30, 2011. The increase in loan fees is related to the increase in the residential first mortgage loan originations during the six months ended June 30, 2011. Commercial loan origination fees are capitalized and added as an adjustment to the basis of the individual loans originated. These fees are accreted into income as an adjustment to the loan yield over the life of the loan or when the loan is sold. We account for substantially all residential first mortgage originations as held-for-sale using the fair value method and no longer apply deferral of non-refundable fees and costs to those loans.

Deposit fees and charges. Our banking operation collects deposit fees and other charges such as fees for non-sufficient funds checks, cashier check fees, ATM fees, overdraft protection, and other account fees for services we provide to our banking customers. Our total number of customer checking accounts decreased 18.6 percent from approximately 132,000 on June 30, 2011 to 107,500 as of June 30, 2012. The divestiture of the Georgia and Indiana banking centers in December 2011 included the sale of approximately 22,000 customer checking accounts and represented most of the decrease.

Three months. Total deposit fees and charges decreased 35.8 percent during the three months ended June 30, 2012 to $5.0 million, compared to $7.8 million during the three months ended June 30, 2011. The primary reason for the decrease in deposit fees and charges was the divestiture of the Georgia and Indiana banking centers in December 2011. Georgia and Indiana combined provided $2.0 million of the deposit fees and charges during the three months ended June 30, 2011. The Federal Reserve final ruling regarding interchange fees had a negative impact on debit card fee income beginning October 1, 2011, with the average fee per transaction dropping from 50 cents during the three months ended June 30, 2011 to 24 cents during the three months ended June 30, 2012.

Six months. Total deposit fees and charges decreased $5.3 million to $10.0 million, or 35.1 percent, during the six months ended June 30, 2012 from $15.3 million during the six months ended June 30, 2011. The primary reason for the decrease in deposit fees and charges was the divestiture of the Georgia and Indiana banking centers in December 2011. Georgia and Indiana combined provided $3.9 million of the deposit fees and charges during the six months ended June 30, 2011. Debit card fee income decreased to $1.3 million during the six months ended June 30, 2012 from $3.7 million during the six months ended June 30, 2011. The Federal Reserve final ruling regarding interchange fees had a negative impact on debit card fee income beginning October 1, 2011, with the average fee per transaction dropping from 50 cents during the six months ended June 30, 2011 to 24 cents during the six months ended June 30, 2012.

Loan administration. When our home lending operation sells mortgage loans in the secondary market, it usually retains the right to continue to service these loans and earn a servicing fee, also referred to herein as loan administration income. Our mortgage servicing rights ("MSRs") are accounted for on the fair value method. See Note 10 of the Notes to the Consolidated Financial Statements, in Item 1. Financial Statements herein.
The following table summarizes net loan administration income (loss).

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2012	2011	2012	2011
	(Dollars in thousands)			
Servicing income on residential first mortgage servicing:				
Servicing fees, ancillary income and charges (1)	$50,743	$42,762	$99,242	$86,382
Fair value adjustments	(84,656)	(48,917)	(91,583)	(44,794)
Gain on hedging activity	58,925	36,605	56,239	28,198
Total net loan administration income (2)	$25,012	$30,450	$63,898	$69,786

(1) Includes the servicing fees, ancillary income and charges on other consumer mortgage servicing.
(2)

Loan administration income does not reflect the impact of securities deployed as economic hedges of MSR assets. These positions, recorded as securities - trading, provided $3.7 million in gains and $2.3 million in losses in the three and six months ended June 30, 2012, respectively, compared to $0.1 million and less than $0.1 million in gains for the three and six months ended June 30, 2011, respectively. These positions, which are on the balance sheet, also contributed $0.4 million and $1.8 million in interest income for the three and six months ended June 30, 2012, respectively, compared to $0.9 million and $1.1 million during the three and six months ended June 30, 2011, respectively.

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Three months. The loan administration income decrease was primarily due to unfavorable fair value adjustments to our MSRs, partially offset by increases in servicing fees, ancillary income, and charges on our residential first mortgage servicing due to an increase in the average balance in the portfolio of loans serviced for others during the three months ended June 30, 2012, compared to the three months ended June 30, 2011. The total unpaid principal balance of loans serviced for others at June 30, 2012 was $76.2 billion, compared to $57.1 billion at June 30, 2011.

Six months. Loan administration income was $63.9 million for the six months ended June 30, 2012, compared to $69.8 million during the six months ended June 30, 2011. The decrease was primarily due to unfavorable fair value adjustments to our MSRs, partially offset by increases in servicing fees, ancillary income, and charges on our residential first mortgage servicing due to an increase in the average balance in the portfolio of loans serviced for others. During the six months ended June 30, 2012 and 2011, we sold servicing rights on a bulk basis associated with underlying mortgage loans totaling $2.4 billion and $4.7 billion, respectively.

At June 30, 2012, we had no consumer loans serviced for others (due to the transfer of such servicing pursuant to the applicable servicing agreements).

Gain (loss) on trading securities. Securities classified as trading are comprised of U.S. Treasury bonds and agency securities. U.S. Treasury bonds held in trading are distinguished from available-for-sale based upon the intent of management to use them as an economic hedge against changes in the valuation of the MSR portfolio, however, these do not qualify as an accounting hedge as defined in current accounting guidance for derivatives and hedges.

Three months. For U.S. Treasury bonds held, we recorded a gain of $3.7 million for the three months ended June 30, 2012, of which $19.5 million was related to a realized gain on the sale of U.S. Treasury bonds and $15.8 million was related to an unrealized loss on U.S. Treasury bonds held at June 30, 2012. For the three months ended June 30, 2011, we recorded a gain of $0.1 million for the three months ended June 30, 2011, all of which was related to an unrealized gain on U.S. Treasury bonds held at June 30, 2011.

Six months. For the six months ended June 30, 2012, we recorded a loss of $(2.3) million on U.S. Treasury bonds held, of which $21.7 million was related to an unrealized loss on U.S. Treasury bonds and $19.4 million was related to a realized gain on the sale of U.S. Treasury bonds held at June 30, 2012. For the six months ended June 30, 2011, we recorded a gain of less than $0.1 million all of which was related to an unrealized gain on agency mortgage-backed securities and U.S. Treasury bonds held at June 30, 2011.

Loss on transferor interests. Losses on transferor's interest are a result of a reduction in the estimated fair value of our beneficial interests resulting from private securitizations. The loss during the three and six months ended June 30, 2012 are primarily due to continued increases in expected credit losses on the assets underlying the securitizations. We have not engaged in any private-label securitization activity since 2007.

Three months. We recognized losses of $1.2 million and $2.3 million for the three months ended June 30, 2012 and June 30, 2011, respectively, all of which was related to a reduction in the transferor's interest related to our HELOC securitizations. At June 30, 2012, our expected liability was $0.4 million, compared to $3.0 million at June 30, 2011.

Six months. For the six months ended June 30, 2012 and June 30, 2011, we recognized a loss of $1.7 million and $4.6 million, respectively, all of which was related to a reduction in the transferor’s interest related to our HELOC securitizations.

Net gain on loan sales. Our home lending operation, or our residential mortgage business, records the transaction fee income it generates from the origination, securitization and sale of mortgage loans in the secondary market. The amount of net gain on loan sales recognized is a function of the volume of mortgage loans originated for sale and the

fair value of these loans, net of related selling expenses. Net gain on loan sales is increased or decreased by any mark to market pricing adjustments on loan commitments and forward sales commitments, increases to the representation and warranty reserve (formerly known as secondary market reserve) related to loans sold during the period, and related administrative expenses. The volatility in the gain on sale spread is attributable to market pricing, which changes with demand and the general level of interest rates. Historically, pricing competition on mortgage loans is lower in periods of low or decreasing interest rates, due to higher consumer demand as usually evidenced by higher loan origination levels, resulting in higher spreads on origination. Conversely, pricing competition increases when interest rates rise, which generally reduce consumer demand, thus decreasing spreads on origination and compressing gain on sale. During the second quarter 2012, the net gain was favorably impacted by the significant volume of mortgage activity due to the attractive rate environment and associated spreads available from securities sold that are guaranteed by Fannie Mae, Freddie Mac and Ginnie Mae.

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The following table provides information on our net gain on loan sales reported in our consolidated financial statements and loans sold within the period.

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2012	2011	2012	2011
	(Dollars in thousands)			
Net gain on loan sales	$212,666	$39,827	$417,518	$90,012
Loans sold or securitized	$12,777,311	$4,362,518	$23,607,109	$10,192,026
Net margin on loan sales	1.66 %	0.91 %	1.77 %	0.88 %

Three months. Net gain on loan sales increased for the three months ended June 30, 2012, compared to the three months ended June 30, 2011, as a result of increased residential first mortgage originations and continued strong margins on sales of the originations, as well as a reduction in overall hedging costs. For the three months ended June 30, 2012, the mortgage rate-lock commitments on residential first mortgages of $17.5 billion increased, compared to $6.4 billion in the three months ended June 30, 2011, and loan sales of $12.8 billion in loans for the three months ended June 30, 2012 also increased, compared to $4.4 billion sold during the three months ended June 30, 2011. The increase in the mortgage rate-lock commitments during the three months ended June 30, 2012, reflected the lower rate environment following an August 2011 announcement by the Federal Reserve stating an intention to maintain a low-interest rate environment until at least 2013. Following such announcement, we experienced a sudden and sustained increase in mortgage rate-lock commitments and a concurrent increase in overall pricing.

Six months. Net gain on loan sales increased during the six months ended June 30, 2012, from the six months ended June 30, 2011. The increase included the sale of $23.6 billion in loans during the six months ended June 30, 2012, compared to $10.2 billion sold in the six months ended June 30, 2011. For the six months ended June 30, 2012, the mortgage rate-lock commitments on residential first mortgages increased to $32.4 billion, compared to $12.0 billion in the six months ended June 30, 2011. The increase in loan sales was primarily due to strong consumer demand for the refinancing of residential mortgage loans in a declining interest rate environment. Additionally, we have been able to strategically take advantage of opportunities given the current displacement in the mortgage market.

Our calculation of net gain on loan sales reflects adoption of fair value accounting for the majority of mortgage loans held-for-sale beginning January 1, 2009. The change of method was made on a prospective basis; therefore, only mortgage loans held-for-sale that were originated after 2009 have been affected. In addition, we also had changes in amounts related to derivatives, lower of cost or market adjustments on loans transferred to held-for-investment and provisions to representation and warranty reserve. Changes in amounts related to loan commitments and forward sales commitments amounted to a gain of $17.0 million and $58.1 million for the three and six months ended June 30, 2012, respectively, compared to a loss of $6.5 million and $47.5 million during the three and six months ended June 30, 2011, respectively. Provisions to our representation and warranty reserve representing our initial estimate of losses on probable mortgage repurchases amounted to $5.6 million and $10.7 million for the three and six months ended June 30, 2012, respectively, compared to $1.4 million and $3.7 million during the three and six months ended June 30, 2011, respectively.

Net loss on sales of mortgage servicing rights. As part of our business model, our home lending operation occasionally sells MSRs in transactions separate from the sale of the underlying loans. Because we carry our MSRs at fair value, we would not expect to realize significant gains or losses at the time of the sale. Instead, our income or loss on changes in the valuation of MSRs would be recorded through our loan administration income.

Three months. For the three months ended June 30, 2012, we recorded a loss on sales of MSRs of $1.0 million, compared to a $2.4 million loss recorded for the three months ended June 30, 2011. During the three months ended June 30, 2012, we had no sales of servicing rights on a bulk basis associated with underlying mortgage loans and $0.2

billion on a servicing released basis (i.e., sold together with the sale of the underlying loans). During the three months ended June 30, 2011, we sold servicing rights on a bulk basis associated with underlying mortgage loans totaling $4.7 billion and on a servicing released basis (i.e., sold together with the sale of the underlying loans) totaling $0.3 billion.

Six months. We recorded a loss on sales of MSRs of $3.3 million for the six months ended June 30, 2012, compared to a $2.5 million loss recorded for the six months ended June 30, 2011. During the six months ended June 30, 2012, we sold servicing rights on a bulk basis associated with underlying mortgage loans totaling $2.4 billion and $0.3 billion on a servicing released basis (i.e., sold together with the sale of the underlying loans). During the six months ended June 30, 2011, we sold servicing rights on a bulk basis associated with underlying mortgage loans totaling $4.7 billion and on a servicing released basis (i.e., sold together with the sale of the underlying loans) totaling $0.8 billion.

Net gain on securities available-for-sale. Securities classified as available-for-sale are comprised of U.S. government sponsored agencies, non-agency collateralized mortgage obligations (“CMOs”) and municipal obligations.

Gains on the sale of U.S. government sponsored agency securities available-for-sale that are recently created with underlying mortgage products originated by the Bank, are reported within net gain on loan sales. Securities in U.S. government sponsored agency securities available-for-sale typically have remained in the portfolio less than 90 days before sale. Gains on sale for all other available-for-sale securities types are reported in net gain on sale of available-for-sale securities.

Three months. During both the three months ended June 30, 2012 and 2011, there were no sales of U.S. government sponsored agencies with underlying mortgage products originated by the Bank. During the three months ended June 30, 2012, we sold $19.3 million of purchased non-agency CMOs, which included a gain on sale of less than $0.1 million. During the three months ended June 30, 2011, there were no sales of non-agency CMOs available-for-sale.

Six months. There were no sales of U.S. government sponsored agencies with underlying mortgage products originated by the Bank during either the six months ended June 30, 2012 or 2011. During the six months ended June 30, 2012, we sold $42.2 million of purchased non-agency CMOs, which included a gain on sale of $0.3 million. During the six months ended June 30, 2011, there were no sales in purchased U.S. government sponsored agencies or non-agency CMOs securities available-for-sale.

During July 2012, we sold $61.4 million in purchased non-agency CMOs, which resulted in a gain on sale of $0.8 million.

Net impairment loss recognized through earnings. We recognize other-than-temporary impairments ("OTTI") related to credit losses through operations with any remainder recognized through other comprehensive income (loss). For the three and six months ended June 30, 2012, there were $1.0 million and $2.2 million, respectively, of credit losses recognized with respect to the CMOs, as the result of forecasted continued depreciation in home values which serve as collateral for these securities. At June 30, 2012, the cumulative amount of OTTI expense incurred due to credit losses on the CMOs totaled $48.0 million. In both the three and six months ended June 30, 2011, there were $15.6 million of credit losses recognized with respect to the CMOs, as the result of forecasted continued depreciation in home values which serve as collateral for these securities. All OTTI due to credit losses were recognized as expense in current operations. For further information on impairment losses, see Note 4 of the Notes to the Consolidated Financial Statements, in Item 1. Financial Statements herein.

Representation and warranty reserve - change in estimate. We maintain a representation and warranty reserve to account for the expected losses related to loans we might be required to repurchase (or the indemnity payments we may have to make to purchasers). The representation and warranty reserve takes into account both our estimate of expected losses on loans sold during the current accounting period, as well as adjustments due to our change in estimate of expected losses from probable repurchase obligations related to loans sold in prior periods.

Estimating the balance of the representation and warranty reserve involves using assumptions regarding future repurchase request volumes, expected loss severity on these requests and claims appeal success rates. The assumptions used to estimate the representation and warranty reserve contain a level of uncertainty and risk that could have a material impact on the reserve balance if they differ from actual results. For instance, to illustrate the sensitivity of the reserve to adverse changes, if the expected levels of demands in the model assumptions increased or decreased by 20.0 percent at June 30, 2012, the result would be a $17.0 million increase or decrease in the representation and warranty reserve balance. If our loss severity rate increased or decreased by 20.0 percent at June 30, 2012, the result would be a $31.0 million increase or decrease in the representation and warranty reserve balance.

Three months. During the three months ended June 30, 2012, we recorded an expense of $46.0 million as an increase in our representation and warranty reserve due to our change in estimate of expected losses from probable repurchase obligations related to loans sold in prior periods, which increased from the $21.4 million recorded in the three months ended June 30, 2011. The increase from the three months ended June 30, 2011, is consistent with recent industry trends, as the GSEs continue to be more aggressive in the number of pre-2009 loans files being reviewed and their interpretation of their rights under the related representations and warranties.

Six months. During the six months ended June 30, 2012, we recorded an expense of $106.6 million for the increase in our representation and warranty reserve due to our change in estimate of expected losses from probable repurchase obligations related to loans sold in prior periods, which increased from the $41.8 million recorded in the six months ended June 30, 2011.

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During late 2011 and throughout the first half of 2012, we continued to see an increase in demand request activity from mortgage investors. As a result of the increased demand request activity and communications with mortgage investors, during the first quarter 2012 we refined the representation and warranty reserve methodology to more effectively incorporate the most recent observable data and trends. This is consistent with the improved risk segmentation and qualitative analysis and modeling performed for other similar reserve estimates, and consistent with expectations of the Bank's primary regulator and the continuing evaluation of the performance dynamics within the mortgage industry. Our enhanced first quarter 2012 methodology added granularity to the model by segmenting the sold portfolio by vintage years and investor to assign assumptions specific to each segment. Key assumptions in the model include investor audits, demand requests, appeal loss rates, loss severity, and recoveries.

Other fees and charges. Other fees and charges include certain miscellaneous fees, including dividends received on FHLB stock and income generated by our subsidiaries, Douglas Insurance Agency, Inc. and Paperless Office Solutions, Inc.

Three months. During the three months ended June 30, 2012, we recorded $2.2 million in dividends on an average outstanding balance of FHLB stock of $301.7 million, compared to $2.1 million in dividends on an average balance of FHLB stock outstanding of $328.3 million for the three months ended June 30, 2011.

Six months. During the six months ended June 30, 2012, we recorded $4.5 million in dividends on an average outstanding balance of FHLB stock of $301.7 million, compared to $4.3 million in dividends on an average balance of FHLB stock outstanding of $331.3 million for the six months ended June 30, 2011.

Non-Interest Expense

The following table sets forth the components of our non-interest expense, along with the allocation of expenses related to loan originations that are deferred pursuant to accounting guidance for receivables, non-refundable fees and other costs. Mortgage loan fees and direct origination costs (principally compensation and benefits) are capitalized as an adjustment to the basis of the loans originated during the period and amortized to expense over the lives of the respective loans rather than immediately expensed. Other expenses associated with loan origination, however, are not required or allowed to be capitalized and are, therefore, expensed when incurred. We account for substantially all of our mortgage loans held-for-sale using the fair value method and, therefore, immediately recognize loan origination fees and direct origination costs in the period incurred rather than defer the cost.

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NON-INTEREST EXPENSE

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2012	2011	2012	2011
	(Dollars in thousands)			
Compensation and benefits	$65,512	$53,749	$131,683	$109,491
Commissions	18,036	7,483	33,824	15,052
Occupancy and equipment	18,706	16,969	35,656	33,587
Asset resolution	20,851	23,282	57,621	61,391
Federal insurance premiums	12,104	10,789	24,428	19,515
Other taxes	374	667	1,335	1,533
Warrant (income) expense	(551)	(1,998)	1,998	(2,825)
General and administrative	34,783	20,057	72,535	40,488
Total	169,815	130,998	359,080	278,232
Less: capitalized direct costs of loan closings	(318)	(76)	(837)	(79)
Total, net	$169,497	$130,922	$358,243	$278,153
Efficiency ratio [1]	53.7%	119.7%	58.5%	107.7%
Efficiency ratio (credit-adjusted) [2]	41.2%	82.3%	41.8%	72.2%

(1) Total operating and administrative expenses divided by the sum of net interest income and non-interest income.
(2) Based on efficiency ratios as calculated, less representation and warranty reserve - change in estimate and asset resolution expense, see “Use of Non-GAAP Financial Measures."

The 29.4 percent increase in non-interest expense during the three months ended June 30, 2012, compared to the three months ended June 30, 2011, was primarily due to an increase in compensation and benefits, commissions and general and administrative expenses (primarily legal fee expense and consulting fees), partially offset by a decrease in asset resolution expense. The 28.8 percent increase in non-interest expense during the six months ended June 30, 2012, compared to the six months ended June 30, 2011, was primarily due to an increase in compensation and benefits, commissions and general and administrative expenses.

Compensation and benefits. The $11.8 million increase in gross compensation and benefits expense for the three months ended June 30, 2012, compared to the three months ended June 30, 2011, is primarily attributable to an $8.2 million increase in compensation and benefits payable and a $1.4 million increase in incentive compensation accruals, primarily related to increased underwriting and loan origination volume. In addition, temporary staffing increased $1.3 million for the three months ended June 30, 2012, compared to the three months ended June 30, 2011.

For the six months ended June 30, 2012, compared to the six months ended June 30, 2011, the $22.2 million increase in gross compensation and benefits expense is primarily attributable to a $13.8 million increase in compensation and benefits payable and a $4.5 million increase in incentive compensation accruals. Temporary staffing increased $1.8 million for the six months ended June 30, 2012, compared to the six months ended June 30, 2011. Our full-time equivalent non-commissioned salaried employees increased overall by 194 from June 30, 2011 to a total of 3,184 at June 30, 2012.

Commissions. Commission expense, which is a variable cost associated with loan originations, totaled $18.0 million, equal to 14 basis points of total loan originations during the three months ended June 30, 2012, compared to $7.5 million, equal to 16 basis points of total loan originations in the three months ended June 30, 2011. The increase in commissions was primarily due to the increase in loan originations for the three months ended June 30, 2012. Loan originations increased to $12.8 billion for the three months ended June 30, 2012 from $4.8 billion for the three months ended June 30, 2011.

During the six months ended June 30, 2012, commission expense totaled $33.8 million, equal to 14 basis points of total loan originations, compared to $15.1 million, equal to 16 basis points of total loan originations in the six months ended June 30, 2011. The increase in commissions is primarily due to an increase in loan originations during the six months ended June 30, 2012. Loan originations increased to $24.2 billion for the six months ended June 30, 2012 from $9.7 billion in the six months ended June 30, 2011.

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Asset resolution. Asset resolution expenses consist of expenses associated with foreclosed properties (including the foreclosure claims in process with respect to government insured loans for which we file claims with the U.S. Department of Housing and Urban Development ("HUD")) and other disposition and carrying costs, loss provisions, and gains and losses on the sale of real estate owned properties that we have obtained through foreclosure or other proceedings.

For the three months ended June 30, 2012 asset resolution expenses decreased $2.4 million to $20.9 million, as compared to $57.6 million during the three months ended June 30, 2011. The decrease was primarily due to a $3.4 million decrease in foreclosure expenses related to commercial loans, a $1.2 million decrease in net repurchase expenses related to government insured loans, offset in part by a $2.9 million increase in foreclosure cost and agency fees related to our loans serviced for others portfolio for the three months ended June 30, 2012, compared to $3.3 million for the three months ended June 30, 2011.

For the six months ended June 30, 2012, asset resolution expense decreased $3.8 million. The decrease was primarily due to a $8.0 million decrease in net repurchase expense related to government insured loans, a $1.1 million decrease in foreclosure expense related to residential real estate owned, a $3.9 million decrease in net foreclosure expense related to commercial loans, partially offset by a $9.1 million increase in foreclosure costs and agency fees related to our loans serviced for others portfolio for the six months ended June 30, 2012, compared to $6.0 million for the six months ended June 30, 2011.

Federal insurance premiums. Our FDIC insurance expense increased for the three months ended June 30, 2012, compared to the three months ended June 30, 2011, largely due to an increase in our average deposits increasing $202.8 million to $6.9 billion for the three months ended June 30, 2012. During the three months ended June 30, 2012, federal insurance premiums totaled $12.1 million, an increase of $1.3 million, compared to $10.8 million for the three months ended June 30, 2011.

For the six months ended June 30, 2012, our FDIC insurance premiums were $24.4 million, compared to $19.5 million for the six months ended June 30, 2011. The increase was primarily due to the use of average reported deposits in the calculation of our assessment base for the first quarter 2011, and the higher average of consolidated total assets for the related periods used thereafter.

Warrant (income) expense. Warrant income decreased to $0.6 million for the three months ended June 30, 2012, compared to income of $2.0 million for the three months ended June 30, 2011. The decrease in warrant income for the three months ended June 30, 2012, was primarily due to the decrease in the market price of our common stock. For the six months ended June 30, 2012 warrant income decreased $4.8 million to an expense of $2.0 million, compared to an income of $2.8 million during the six months ended June 30, 2011. At June 30, 2012, warrants to purchase 6.9 million shares of our common stock with a fair value of $4.4 million were outstanding, compared to warrants to purchase 6.9 million shares of our common stock with a fair value of $2.4 million outstanding at December 31, 2011. The overall increase in warrant expense is attributable to the increase in the market price of our common stock since December 31, 2011.

General and administrative. General and administrative expense increased $14.7 million during the three months ended June 30, 2012, as compared to the three months ended June 30, 2011. The increase was primarily due to a $7.9 million increase in our outside consulting, audit and legal expenses which increased from $5.2 million for the three months ended June 30, 2011 to $13.1 million for the three months ended June 30, 2012. In addition, our loan processing expenses increased $7.9 million during the three months ended June 30, 2012 from the three months ended June 30, 2011, reflecting the increased loan origination volume for the three months ended June 30, 2012, compared to $2.2 million for the three months ended June 30, 2011.

General and administrative expense increased $32.0 million during the six months ended June 30, 2012, from the six months ended June 30, 2011. The increase was primarily due to a $20.2 million increase in our outside consulting, audit and legal expenses for the six months ended June 30, 2012 and a $10.7 million increase in loan processing expenses for the six months ended June 30, 2012 as a result of the increased loan origination volume.

Provision (Benefit) for Federal Income Taxes

For both the three and six months ended June 30, 2012, our provision (benefit) for federal income taxes as a percentage of pretax income was 0.6 percent, as compared to 0.4 percent and 0.5 percent for the three and six months ended June 30, 2011. For each year, the provision (benefit) for federal income taxes varies from statutory rates primarily because of a change in balance to our valuation allowance for net deferred tax assets.

Deferred taxes are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. In addition, a deferred tax asset is recorded for net operating loss carry forwards and unused tax credits. Deferred tax assets and liabilities are measured using enacted tax rates that will 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 is recognized as income or expense in the period that includes the enactment date.

We periodically review the carrying amount of our deferred tax assets to determine if the establishment of a valuation allowance is necessary. If based on the available evidence, it is more likely than not that all or a portion of our deferred tax assets will not be realized in future periods, a deferred tax valuation allowance would be established. Consideration is given to all positive and negative evidence related to the realization of the deferred tax assets.

In evaluating this available evidence, we consider historical financial performance, expectation of future earnings, the ability to carry back losses to recoup taxes previously paid, length of statutory carry forward periods, experience with operating loss and tax credit carry forwards not expiring unused, tax planning strategies and timing of reversals of temporary differences. Significant judgment is required in assessing future earnings trends and the timing of reversals of temporary differences. Our evaluation is based on current tax laws as well as our expectations of future performance.

We recorded a $348.2 million and $383.8 million valuation allowance against deferred tax assets as of June 30, 2012 and December 31, 2011, respectively. See Note 19 of the Notes to the Consolidated Financial Statements, in Item 1. Financial Statements herein.

Analysis of Items on Statements of Financial Condition

Assets

Interest-earning deposits. Interest-earning deposits, on which we earn a minimal interest rate, increased $517.9 million at June 30, 2012 compared to December 31, 2011, primarily due to on-going strategic initiatives to increase lending. Our interest-earning deposits allow the flexibility to fund our on-going initiatives to increase commercial lending, as well as other mortgage related initiatives.

Securities classified as trading. Securities classified as trading are comprised of AAA-rated, U.S. Treasury bonds. Changes to the fair value of trading securities are recorded in the Consolidated Statements of Operations. At June 30, 2012 there were $169.8 million securities classified as trading, compared to $313.4 million at December 31, 2011. U.S. Treasury bonds held in trading are distinguished from those classified as available-for-sale based upon the intent of management to use them as an offset against changes in the valuation of the MSR portfolio, however, these do not qualify as an accounting hedge. See Note 4 of the Notes to the Consolidated Financial Statements, in Item 1. Financial Statements herein.

Securities classified as available-for-sale. Securities classified as available-for-sale, which are comprised of U.S. government sponsored agencies, non-agency CMOs and municipal obligations, decreased from $481.4 million at December 31, 2011, to $424.8 million at June 30, 2012. See Note 4 of the Notes to the Consolidated Financial Statements, in Item 1. Financial Statements herein.

Loans held-for-sale. A majority of our mortgage loans produced are sold into the secondary market on a whole loan basis or by securitizing the loans into mortgage-backed securities. At June 30, 2012, we held loans held-for-sale of $2.5 billion, which was an increase of $0.7 billion from $1.8 billion held at December 31, 2011. Loan origination is typically inversely related to the level of long-term interest rates. As long-term rates decrease, we tend to originate an increasing number of mortgage loans. A significant amount of the loan origination activity during periods of falling interest rates is derived from refinancing of existing mortgage loans. The increase in the balance of loans held-for-sale was principally attributable to the timing of loan sales. For further information on loans held-for-sale, see Note 5 of the Notes to the Consolidated Financial Statements, in Item 1. Financial Statements herein.

Loans repurchased with government guarantees. Pursuant to Ginnie Mae servicing guidelines, we have the unilateral option to repurchase certain delinquent loans securitized in Ginnie Mae pools, if the loans meet defined criteria. As a result of this unilateral option, once the delinquency criteria have been met and regardless of whether the repurchase option has been exercised. We must treat the loans as having been repurchased and recognize the loans on the Consolidated Statements of Financial Condition and also recognize a corresponding deemed liability for a similar amount. If the loans are actually repurchased, we eliminate the corresponding liability. At June 30, 2012, the amount of such loans actually repurchased totaled $2.0 billion and were classified as loans repurchased with government guarantees. These loans which we have not yet repurchased but had the unilateral right to repurchase totaled $83.6 million and were classified as loans held-for-sale.

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At December 31, 2011, the amount of such loans actually repurchased totaled $1.9 billion and were classified as loans repurchased with government guarantees, and those loans which we have not yet repurchased but had the unilateral right to repurchase totaled $117.2 million and were classified as loans held-for-sale. The loans repurchased with government guarantees remained relatively stable from December 31, 2011 to June 30, 2012.

Substantially all of these loans continue to be insured or guaranteed by the FHA and management believes that the reimbursement process is proceeding appropriately. On average, claims have historically been filed and paid within approximately 18 months from the date of the initial delinquency. However, increasing volumes throughout the country, as well as changes in the foreclosure process in states throughout the country and other forms of government intervention may result in changes to the historical norm. These repurchased loans earn interest at a statutory rate, which varies for each loan, but is based on the 10-year U.S. Treasury note rate at the time the loan becomes greater than 90 days past due. This interest is recorded as interest income and the related claims settlement expenses are recorded in asset resolution expense on the Consolidated Statements of Operations. For further information on loans repurchased with government guarantees, see Note 6 of the Notes to the Consolidated Financial Statements, in Item 1. Financial Statements herein.

Loans held-for-investment. Our largest category of earning assets consists of loans held-for-investment. Loans held-for-investment consist of residential first mortgage loans that are not held for resale (usually shorter duration and adjustable rate loans and second mortgages), warehouse loans to other mortgage lenders, HELOC, other consumer loans, commercial real estate loans, commercial and industrial loans, and commercial lease financing loans. Loans held-for-investment decreased from $7.0 billion at December 31, 2011, to $6.6 billion at June 30, 2012, primarily due to residential first mortgage loans declining 17.3 percent to $3.1 billion at June 30, 2012, compared to December 31, 2011. Commercial and industrial loans increased $240.4 million to $569.3 million at June 30, 2012 from $328.9 million at December 31, 2011. Commercial lease financing increased to $159.1 million at June 30, 2012, compared to $114.5 million at December 31, 2011. For information relating to the concentration of credit of our loans held for investment, see Note 7 of the Notes to the Consolidated Financial Statements, in Item 1. Financial Statement and Supplementary Data, herein.

Quality of Earning Assets

Management considers a number of qualitative and quantitative factors in assessing the level of its collectively evaluated, in accordance with ASC 310-10, and individually evaluated, in accordance with ASC 450-20, reserves. See "Allowance for Loan Losses" following. As illustrated in the tables following, trends in certain credit quality characteristics such as nonperforming loans and delinquency statistics have recently stabilized or even begun to show signs of improvement. This is predominantly a result of the run off of the legacy portfolios combined with the addition of new commercial loans with better credit characteristics.

A breakout of the components of our allowance for loan losses, by loan portfolio type, is provided in Note 7 of the Notes to the Consolidated Financial Statements, in Item 1. Financial Statements, herein. For residential first mortgage loans, management believes the decrease in the total allowance for loan losses from December 31, 2011 to June 30, 2012 is directionally consistent with the decrease in delinquent loans and the decrease in ending unpaid principle balance ("UPB") over the same linked period. For second mortgage and HELOC loans, the total allowance for loan losses increased from December 31, 2011 to June 30, 2012 despite a lower level of delinquent loans and a lower ending UPB over the same period. Management believes this reflects a higher severity upon default, as second mortgage and HELOC loans do not generally have any remaining collateral. For commercial loans, management believes the decrease in the total allowance for loan losses from December 31, 2011 to June 30, 2012 is directionally consistent with the decrease in delinquent loans over the same linked period. Ending UPB for commercial loans increased as of June 30, 2012, as compared to December 31, 2011, reflecting the origination of "new" commercial loans, which are originated under an enhanced underwriting structure and therefore have a lower associated loss rate applied

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The following table sets forth certain information about our non-performing assets as of the end of each of the last five quarters.

NON-PERFORMING LOANS AND ASSETS

	June 30, 2012	March 31, 2012	December 31, 2011	September 30, 2011	June 30, 2011
	(Dollars in thousands)				
Non-performing loans (1)	$431,599	$406,583	$488,367	$ 444,887	$403,381
Real estate and other non-performing assets, net (1)	107,235	108,686	114,715	113,365	110,050
Non-performing assets held-for-investment, net	538,834	515,269	603,082	558,252	513,431
Non-performing loans held-for-sale	2,430	2,842	4,573	3,331	5,341
Total non-performing assets including loans held-for-sale	$541,264	$518,111	$607,655	$ 561,583	$518,772
Ratio of non-performing assets to total assets (bank only)	3.75 %	3.67 %	4.43 %	4.09 %	4.06 %
Ratio of non-performing loans held for investment to loans held-for-investment (1)	6.59 %	6.11 %	6.94 %	6.52 %	6.75 %
Ratio of allowance to non-performing loans held-for-investment	66.5 %	69.1 %	65.1 %	63.4 %	67.9 %
Ratio of allowance to loans held-for-investment	4.38 %	4.22 %	4.52 %	4.13 %	4.59 %
Ratio of net charge-offs to average loans held-for- investment	0.81 %	2.25 %	0.40 %	0.46 %	0.79 %

(1) During the second quarter 2011, approximately $30 million was reclassified from real estate and other non-performing assets to non-performing loans. This was related to the classifications described in Note 6 of the Notes to the Consolidated Financial Statements, in Item 1. Financial Statement, herein. Excluding this reclassification, the ratio of non-performing loans held for investment to total loans held-for-investment would have been 6.28 percent at June 30, 2011.

The following table provides the activity for non-performing commercial assets, which includes commercial real estate and commercial and industrial loans.

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2012	2011	2012	2011
	(Dollars in thousands)			
Beginning balance	$134,421	$240,006	$145,006	$253,934
Additions	118,073	36,003	183,851	63,896
Returned to performing	(2)	(3,729)	(11,170)	(18,701)
Principal payments	(20,106)	(8,803)	(21,970)	(10,647)
Sales	(4,053)	(78,237)	(17,136)	(82,480)
Charge-offs, net of recoveries	(41,882)	(25,504)	(86,499)	(44,112)
Valuation write-downs	(2,713)	(3,484)	(8,344)	(5,638)
Ending balance	$183,738	$156,252	$183,738	$156,252

Past due loans held-for-investment

Loans are considered to be past due when any payment of principal or interest is past due. While it is the goal of management to work out a satisfactory repayment schedule or modification with a past due borrower, we will undertake foreclosure proceedings if the delinquency is not satisfactorily resolved. Our procedures regarding past due loans are designed to assist borrowers in meeting their contractual obligations. We customarily mail several notices of past due payments to the borrower within 30 days after the due date and late charges are assessed in accordance with certain parameters. Our collection department makes telephone or personal contact with borrowers after loans are 30 days past due. In certain cases, we recommend that the borrower seek credit-counseling assistance and may grant forbearance if it is determined that the borrower is likely to correct a past due loan within a reasonable period of time. We cease the accrual of interest on loans that we classify as “non-performing” once they are greater than 90 days past due or earlier when concerns exist as to the ultimate collection of principal or interest. Such interest is recognized as income only when it is actually collected.

At June 30, 2012, we had $522.5 million of loans held-for-investment that were determined to be past due loans. Of those past due loans, $431.6 million of loans were non-performing held-for-investment, of which $282.9 million, or 65.5 percent, were residential first mortgage loans. At December 31, 2011, we had $633.5 million of loans held-for-investment that were determined to be past due loans. Of those past due loans, $488.4 million of loans were non-performing held-for-investment, of which $378.8 million, or 77.6 percent, were single-family residential mortgage loans. At June 30, 2012, non-performing loans held-for-sale totaled $2.4 million, compared to $4.6 million at December 31, 2011. The $0.5 million increase from December 31, 2011 to June 30, 2012 in non-performing loans held-for-sale, was primarily due to the sale of non-performing residential first mortgage loans at a sale price which approximated carrying value.

Residential first mortgage loans. As of June 30, 2012, non-performing residential first mortgages decreased to $282.9 million, a decrease of $89.6 million from $372.5 million at December 31, 2011. This decrease resulted from the charge-down of all specific valuations allowances to conform with the OCC's application of regulatory guidance as the Bank transitioned to Call Report requirements in the first quarter 2012. Although our portfolio is diversified throughout the United States, the largest concentrations of loans are in California, Florida and Michigan. Each of those real estate markets has experienced steep declines in real estate values beginning in 2007 and continuing through 2012. Net charge-offs within the residential first mortgage portfolio totaled $16.0 million and $110.9 million for the three and six months ended June 30, 2012, respectively, compared to $9.1 million and $11.7 million for the three and six months ended June 30, 2011, respectively. As discussed above, the increase in net charge-offs was largely driven by the elimination of specific valuation allowances.

Commercial real estate loans. The commercial real estate portfolio experienced some deterioration in credit beginning in mid-2007 primarily in the commercial land residential development loans. Credit deterioration in this segment has slowed in 2011 and into 2012. Non-performing commercial real estate loans have as a percent of the commercial real estate portfolio increased to 12.8 percent in June 30, 2012 from 8.0 percent at December 31, 2011. Net charge-offs within the commercial real estate portfolio totaled $28.9 million and $72.0 million for the three and six months ended June 30, 2012, respectively, which was an increase from $25.5 million and $44.1 million for the three and six months ended June 30, 2011, respectively.

Troubled Debt Restructurings (Held-for-Investment)

Troubled debt restructures ("TDRs") are modified loans in which a concession not otherwise available is provided to a borrower experiencing financial difficulties. Our ongoing loan modification efforts to assist homeowners and other borrowers continued to increase our overall level of TDRs. Non-performing TDRs were 30.8 percent and 40.3 percent of total non-performing loans at June 30, 2012 and December 31, 2011, respectively.

TDRs can be classified as either performing or non-performing. Non-performing TDRs are included in non-accrual loans and performing TDRs are excluded from non-accrual loans because it is probable that all contractual principal and interest due under the restructured terms will be collected. At June 30, 2012, TDRs included in non-performing loans were $133.1 million, compared to $196.6 million as of December 31, 2011. Within consumer non-performing loans, residential first mortgage TDRs were 43.3 percent of residential first mortgage non-performing loans at June 30, 2012, compared to 44.4 percent at December 31, 2011. The level of modifications that were determined to be TDRs in these portfolios is expected to result in elevated non-performing loan levels for longer periods, because TDRs remain in non-performing status until a borrower has made at least six consecutive months of payments under the modified terms, or ultimate resolution occurs. TDRs primarily reflect our loss mitigation efforts to proactively work with borrowers having difficulty making their payments.

Explanation of Responses:

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	TDRs Held-for-Investment		
	Performing	Non-performing	Total
	(Dollars in thousands)		
June 30, 2012			
Consumer loans [1]	$574,359	$ 126,312	$700,671
Commercial loans [2]	1,738	6,776	8,514
Total TDRs	$576,097	$ 133,088	$709,185
December 31, 2011			
Consumer loans [1]	$499,438	$ 167,076	$666,514
Commercial loans [2]	17,737	29,509	47,246
Total TDRs	$517,175	$ 196,585	$713,760

(1) Consumer loans include: residential first mortgage, second mortgage, warehouse lending, HELOC and other consumer loans. The allowance for loan losses on consumer TDR loans totaled $102.0 million and $85.2 million at June 30, 2012 and December 31, 2011, respectively.

(2) Commercial loans include: commercial real estate, commercial and industrial and commercial lease financing loans. The allowance for loan losses on commercial TDR loans totaled $0.6 million and $32.2 million at June 30, 2012 and December 31, 2011, respectively.

Total TDRs decreased to $709.2 million at June 30, 2012 from $713.8 million at December 31, 2011. Of the total TDRs at June 30, 2012, non-performing TDRs totaled $133.1 million, which represents approximately 30.8 percent of total non-performing loans. TDRs that have returned to performing (accrual) status are excluded from non-performing loans. These loans have demonstrated a period of at least six months of consecutive performance under the modified terms. Performing TDRs increased $58.9 million at June 30, 2012 to $576.1 million, compared to $517.2 million at December 31, 2011.

	TDRs Held-for-Investment			
	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2012	2011	2012	2011
Performing	(Dollars in thousands)			
Beginning balance	$537,236	$588,094	$517,176	$605,099
Additions	39,731	232,185	79,140	255,274
Transfer to nonperforming TDR	(25,649)	(19,407)	(53,584)	(73,287)
Transfer from nonperforming TDR	38,697	3,029	61,170	29,086
Principal repayments	(5,196)	(896)	(12,316)	(1,779)
Reductions (1)	(8,722)	(255,526)	(15,489)	(266,914)
Ending balance	$576,097	$547,479	$576,097	$547,479
Nonperforming				
Beginning balance	$159,129	$149,054	$196,585	$124,535
Additions	18,271	56,448	39,972	69,880
Transfer from performing TDR	25,649	19,407	53,584	73,287
Transfer to performing TDR	(38,697)	(3,029)	(61,170)	(29,086)
Principal repayments	(6,452)	(2,149)	(39,417)	(6,580)
Reductions (1)	(24,812)	(85,756)	(56,466)	(98,061)
Ending balance	$133,088	$133,975	$133,088	$133,975

(1) Includes loans paid in full or otherwise settled, sold or charged off.

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The following table sets forth information regarding past due loans at the dates listed. At June 30, 2012, 67.2 percent of all past due loans were loans in which we had a first lien position on residential real estate, compared to 76.6 percent at December 31, 2011.

PAST DUE LOANS HELD-FOR-INVESTMENT

Days Past Due	June 30, 2012	December 31, 2011
	(Dollars in thousands)	
30 – 59 days		
Consumer loans:		
Residential first mortgage	$55,590	$74,934
Second mortgage	1,632	1,887
HELOC	4,204	5,342
Other	697	1,507
Commercial loans:		
Commercial real estate	1,718	7,453
Commercial and industrial	1	11
Total 30-59 days past due	63,842	91,134
60 – 89 days		
Consumer loans:		
Residential first mortgage	22,252	37,493
Second mortgage	589	1,527
HELOC	1,756	2,111
Other	165	471
Commercial loans:		
Commercial real estate	2,345	12,323
Commercial and industrial	—	62
Total 60-89 days past due	27,107	53,987
Greater than 90 days		
Consumer loans:		
Residential first mortgage	282,898	372,514
Second mortgage	6,147	6,236
Warehouse lending	28	28
HELOC	4,126	7,973
Other	275	611
Commercial loans:		
Commercial real estate	138,069	99,335
Commercial and industrial	56	1,670
Total greater than 90 days past due	431,599	488,367
Total past due loans	$522,548	$633,488

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The following table sets forth information regarding non-performing loans (i.e., greater than 90 days past due loans) as to which we have ceased accruing interest.

NON-ACCRUAL LOANS HELD-FOR-INVESTMENT

	At June 30, 2012					
	Investment Loan Portfolio	Non-Accrual Loans	As a % of Loan Specified Portfolio		As a % of Non-Accrual Loans	
	(Dollars in thousands)					
Consumer loans:						
Residential first mortgage	$3,102,137	$282,898	9.1	%	66.4	%
Second mortgage	127,434	6,147	4.8	%	1.4	%
Warehouse lending	1,261,442	28	—	%	—	%
HELOC	198,228	4,126	2.1	%	1.0	%
Other consumer	57,605	266	0.5	%	0.1	%
Total consumer loans	4,746,846	293,465	6.2	%	68.9	%
Commercial loans:						
Commercial real estate	1,075,015	132,583	12.3	%	31.1	%
Commercial and industrial	569,288	56	—	%	—	%
Commercial lease financing	159,108	—	—	%	—	%
Total commercial loans	1,803,411	132,639	7.4	%	31.1	%
Total loans	6,550,257	$426,104	6.5	%	100.0	%
Less allowance for loan losses	(287,000)					
Total loans held-for-investment, net	$6,263,257					

The following table sets forth the non-performing loans (i.e., greater than 90 days past due loans) residential first mortgage loans by year of origination (i.e., vintage) and the total amount of unpaid principal balance loans outstanding at June 30, 2012.

RESIDENTIAL FIRST MORTGAGE LOANS HELD-FOR-INVESTMENT

	At June 30, 2012		
Vintage	Performing Loans	Non-Accrual Loans	Unpaid Principal Balance
	(Dollars in thousands)		
Pre-2003	$71,313	$ 7,039	$78,352
2003	179,994	10,473	190,467
2004	559,953	22,434	582,387
2005	614,098	30,057	644,155
2006	242,506	21,811	264,317
2007	901,357	116,717	1,018,074
2008	71,761	41,378	113,139
2009	46,943	15,348	62,291
2010	21,054	3,785	24,839
2011	37,204	6,337	43,541
2012	35,852	7,519	43,371
Total loans	$2,782,035	$ 282,898	3,064,933
Net deferred fees and other			37,204
Total residential first mortgage loans			$3,102,137

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Allowance for Loan Losses

The allowance for loan losses represents management's estimate of probable losses in our loans held-for-investment portfolio as of the date of the Consolidated Financial Statements. The allowance provides for probable losses that have been identified with specific customer relationships, individually evaluated, and for probable losses believed to be inherent in the loan portfolio but that have not been specifically identified, collectively evaluated.

As part of our ongoing risk assessment process which remains focused on the impact of the current economic environment and the related borrower repayment behavior on our credit performance, management has been working with an industry expert to improve credit risk modeling process and continue to back test and validate the results of quantitative and qualitative modeling of the risk in its loans held-for-investment portfolio. This is consistent with the expectations of our primary regulator and with the continuing evolution of the performance dynamics within the mortgage industry. As a result of an analysis completed during the first quarter 2012, we determined it was appropriate to make refinements to the allowance for loan loss methodology and related model. The first quarter 2012 refinements included improved risk segmentation and quantitative analysis, and enhancements to and alignment of the qualitative risk factors.

We maintain an allowance for loan losses at a level that management determines is appropriate to absorb estimated losses in our loan portfolio. The impact of the refinements adopted during the first quarter 2012 resulted in an increase to the level of allowance for loan losses management deemed appropriate to absorb losses, which totaled $59.0 million in the consumer portfolio and $11.0 million in the commercial portfolio.

The following key refinements were made:

First, we utilized refined segmentation and more formal qualitative factors during the first quarter 2012, which resulted in an increase in the adjusted historical factors used to calculate the ASC 450-20 allowance related to the consumer portfolio. Historically, we segmented the population of consumer loans held-for-investment (“LHFI”) by product type and by delinquency status for purposes of estimating an adequate allowance for loan losses. Management performed a thorough analysis of the largest product type, residential first mortgage loans, to assess the relative reliability of its risk segmentation in connection with the ability to detect losses inherent in the portfolio, and determined that there was a higher correlation of loan losses to LTV ratios than to delinquency status. As a result, management refined its process to use LTV segmentation, rather than product and delinquency segmentation, as the more appropriate consumer residential loan characteristic in determining the related allowance for loan losses.

Additionally, we created a more formal process and framework surrounding the qualitative factors and better aligned the factors with regulatory guidance and the changes in the mortgage environment. Management formally implemented a qualitative factor matrix related to each loan class in the consumer portfolio in the first quarter 2012, which includes the following factors: changes in lending policies and procedures, changes in economic and business conditions, changes in the nature and volume of the portfolio, changes in lending management, changes in credit quality statistics, changes in the quality of the loan review system, changes in the value of underlying collateral for collateral-dependent loans, changes in concentrations of credit, and other external factor changes. These factors are used to reflect changes in the collectability of the portfolio not captured by the historical loss rates. As such, the qualitative factors supplement actual loss experience and allow us to better estimate the loss within the loan portfolios based upon market and other indicators. Qualitative factors are analyzed to determine a quantitative impact of each factor which adjusts the historical loss rate. Adjusted historical loss rates are then used in the calculation of the allowance for loan losses. The adjusted historical loss rates at March 31, 2012 were higher than those used in the calculation of the consumer allowance for loan losses at December 31, 2011, thereby resulting in an increase to the 2012 level of allowance for loan losses.

Second, to allow us the appropriate amount of time to analyze portfolio statistics and allow for the appropriate validation of the reasonableness of the new qualitative factors, management adjusted the historical look back period for loss rates to lag a quarter (as compared to the previous policy of a month). This adjustment resulted in a decrease to the 2012 level of allowance for loan losses, as compared to the 2011 level of allowance for loan losses, partially offsetting the increase resulting from the refined segmentation.

Third, the commercial loan portfolio was segmented into commercial “legacy” loans (loans originated prior to January 1, 2011) and commercial “new” loans (loans originated on or after January 1, 2011) while still retaining the segmentation by product type. Due to the changes in our strategy and to changes in underwriting and origination practices and controls related to that strategy, management determined the refined segmentation better reflected the dynamics in the two portfolios. The loss rates attributed to the “legacy” portfolio are based on historical losses of this segment. Due to the brief period of time that loans in the “new” portfolio were outstanding, and thus the absence of a sufficient loss history for that portfolio, we had used loss data from a third party data aggregation firm (adjusting for our qualitative factors) as a proxy for estimating an allowance for loan losses on

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the “new” portfolio. As a refinement in the first quarter 2012, we separately identified a population of commercial banks with similar size balance sheets (and loan portfolios) to serve as our peer group. We now use this peer group's publicly available historical loss data (adjusted for our qualitative factors) as a new proxy for loss rates used to determine the allowance for loan losses on our “new” commercial portfolio. This refined segmentation resulted in an increase to the 2012 level of allowance for loan losses, as compared to the 2011 level of allowance for loan losses.

Fourth, as a result of these refinements (in addition to the refinements noted below), management has determined that it no longer requires an unallocated portion of allowance for loan losses. Management expects to review these models on an ongoing basis and update them as appropriate to reflect then-current industry conditions, heightened access to enhanced loss data, and refinements based upon continuous back testing of the allowance for loan losses model. This change to the unallocated reserve resulted in a decrease to the 2012 level of allowance for loan losses, as compared to the 2011 level of allowance for loan losses.

Lastly, part of the increase in allowance for loan losses was a result of the TDR refinement. Historically, we performed impairment analysis on TDRs by using the discounted cash flows method on a portfolio or pooled approach when the TDRs were not deemed collateral dependent. During the fourth quarter 2011, management adopted a strategic focus that improved loss mitigation processes so that we could continue the rate of loan modifications and other loss mitigation activities. Due to the emphasis on loss mitigation activities, management implemented new procedures relating to “new” TDRs (loans that were designated TDRs generally beginning on or after October 1, 2011) to capture the necessary data to perform the impairment analysis on a portfolio level. Such data was not previously available and currently continues to not be available for loans designated as TDRs prior to September 30, 2011. This data is now being captured in part due to our loan servicing system conversion in late 2011. As such, for a significant percentage of “new” TDRs, management was able to perform the impairment calculation on a portfolio basis. Given data constraints the “old” TDR portfolio as of December 31, 2011, is still utilizing the pooled approach. This refinement resulted in an increase to the 2012 level of allowance for loan losses, as compared to the 2011 level of allowance for loan losses. Management expects to continue to refine this process for operational efficiency purposes that will allow for periodic review and updates of impairment data of all TDRs grouped by similar risk characteristics.

Accounting standards require a reserve to be established as a component of the allowance for loan losses when it is probable all amounts due will not be collected pursuant to the contractual terms of the loan and the recorded investment in the loan exceeds its fair value. Fair value is measured using either the present value of the expected future cash flows discounted at the loan's effective interest rate, the observable market price of the loan, or the fair value of the collateral if the loan is collateral dependent, reduced by estimated disposal costs.

Nonperforming commercial and commercial real estate loans are considered to be impaired and typically have an allowance allocated based on the underlying collateral's appraised value, less management's estimates of costs to sell. In estimating the fair value of collateral, we utilize outside fee-based appraisers to evaluate various factors such as occupancy and rental rates in our real estate markets and the level of obsolescence that may exist on assets acquired from commercial business loans. Appraisals are updated at least annually but may be obtained more frequently if changes to the property or market conditions warrant.
Impaired residential loans include loan modifications considered to be TDRs and certain nonperforming loans that have been charged-down to collateral value. Fair value of nonperforming residential mortgage loans, including re-defaulted TDRs and certain other severely past due loans, is based on the underlying collateral's value obtained through appraisals or broker's price opinions, updated at least semi-annually, less management's estimates of cost to sell. The allowance allocated to TDRs performing under the terms of their modification is typically based on the present value of the expected future cash flows discounted at the loan's effective interest rate, either on a loan level or pooled basis, as these loans are not considered to be collateral dependent.

Once a commercial loan (greater than $250,000) that is secured principally by real estate is risk rated special mention or more negative, an updated appraisal is ordered. (Commercial loans less than $250,000 that are secured principally by real estate follow the same process, but a broker price opinion (“BPO”) is obtained instead of an appraisal.) The appraisal received is reviewed by our Commercial Appraisal and Risk Management Group (“CARM”) for reasonableness. CARM has the authority to adjust the appraised value if deemed warranted or request a new or revised appraisal if needed. CARM has the responsibility for establishing and maintaining appraisal guidelines and procedures to ensure compliance with the Bank's policies and applicable regulations. As part of its responsibilities, CARM reviews the qualifications of appraisers and establishes, reevaluates, and monitors a list of approved real estate appraisers. As long as a loan continues to be risk rated special mention or more negative, the Bank requires, at a minimum, that an updated appraisal be obtained on the underlying collateral at least annually. Based on the specific facts and circumstances of each loan, an appraisal may be obtained more frequently if warranted.

To determine the amount of impairment to record on an impaired commercial loan that is deemed collateral dependent, the Bank uses the "as is” market value from the appraisal as a starting point. Appraisals that are less than 180 days old are discounted 10 percent to determine the adjusted appraised value or net realizable value of the collateral. This discount reflects the passage of

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time and includes estimated costs to sell the underlying collateral. Appraisals that are greater than 180 days old but less than one year old are discounted by 15 percent. Lastly, appraisals that are greater than one year old are discounted by 25 percent. Additionally, impaired commercial loans are reviewed at a minimum of a quarterly basis to ensure the appropriateness of the calculated impairment that has been recorded. Periodically, these discounts and adjusted appraised values are validated by back-testing against the actual proceeds received from the sale of collateral.

Additionally, throughout the life of the loan, the credit risk management area performs portfolio reviews to validate the risk ratings provided by the loan officers. Also, the Bank’s independent internal loan review department and/or its third party loan review firm reviews loans and validates the risk ratings, with more active oversight and monitoring for higher risk and high dollar relationships and loan balances. Based upon the results of such oversight and monitoring, updated appraisals may be ordered.

For consumer loans secured by residential real estate (which are not government insured nor designated as troubled debt restructurings), our policy is to request a BPO when the loan is 150 days delinquent. Once the BPO is obtained, it is reviewed for reasonableness. Our policy is to discount the BPO by 20 percent, which the Bank believes is appropriate so that the BPO, as adjusted, generally approximates the fair value of the underlying residential real-estate collateral. An additional 10-15 percent discount is taken to estimate the selling costs of the property. Such estimates of the fair value less estimated selling costs (i.e., to determine net realizable value) are used to determine the applicable charge-off against the allowance for loan losses. Additionally, once the loan moves to repossessed assets and we begin to market the property, we request an appraisal and at least one BPO. While the property is being marketed, we are provided with a new BPO every 30 to 60 days until liquidation. If the property does not sell within 12 months of the date it was moved to real estate owned, we obtain an appraisal.

For consumer TDRs secured by residential real estate, our policy is to request a BPO when the loan is 60 days delinquent. When a consumer TDR is 90 days delinquent, it is deemed to have re-defaulted and becomes collateral-dependent and an appraisal rather than a BPO is ordered.

For those loans not individually evaluated for impairment, management sub-divided the commercial and consumer loans into homogeneous portfolios.

The commercial loan portfolio is segmented into commercial “legacy” loans (loans originated prior to January 1, 2011) and commercial “new” loans (loans originated on or after January 1, 2011) while still retaining the segmentation by product type. Due to the changes in our strategy and to changes in underwriting and origination practices and controls related to that strategy, management determined the refinement was added to better reflect the dynamics in the two portfolios. The loss rates attributed to the “legacy” portfolio is based on historical losses of this segment. Due to the lack of seasoning in the “new” portfolio, we were previously utilizing loss data from a third party (adjusting for our qualitative factors) as a proxy for estimating an allowance on its “new” portfolio. As a refinement in the first quarter 2012, we identified a population of commercial banks with similar size balance sheets (and loan portfolios) to serve as a peer group. We now uses this peer group's publicly available historical loss data (adjusted for our qualitative factors) as a new proxy for their loss rates.
Historically, we segmented the population of consumer loans by product type and by past due status for purposes of determining an appropriate allowance for loan loss. Management performed a thorough analysis of its largest product type, residential mortgage loans, and its risk segmentation in connection with its model's ability to predict losses inherent in the portfolio, and determined it would segment the portfolio by LTV rather than past due loan status. This is consistent with a shift in the mortgage market as to the relevance of various indicators. The portion of the allowance allocated to other consumer and residential mortgage loans is determined by applying projected loss ratios to various segments of the loan portfolio. Projected loss ratios are qualitatively adjusted for certain past due statistics, loss severity trends, economic and regulatory considerations, etc.

As the process for determining the adequacy of the allowance requires subjective and complex judgment by management about the effect of matters that are inherently uncertain, subsequent evaluations of the loan portfolio, in light of the factors then prevailing, may result in significant changes in the allowance for loan losses. In estimating the amount of credit losses inherent in our loan portfolio various assumptions are made. For example, when assessing the condition of the overall economic environment assumptions are made regarding current economic trends and their impact on the loan portfolio. If the anticipated recovery is not as strong or timely as management's expectations, it may affect the estimate of the allowance for loan losses. For impaired loans that are collateral dependent, the estimated fair value of the collateral may deviate significantly from the net proceeds received when the collateral is sold.

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Determination of the probable losses inherent in the loan portfolio, which is not necessarily captured by the allocation methodology discussed above, involves the exercise of judgment. In addition, the OCC, as part of its supervisory function, periodically reviews our allowance for loan losses. The OCC may require us to increase our provision for loan losses or to recognize further losses, based on its judgment, which may be different from that of our management. The results of such reviews could have a material effect on the Bank's loan classifications and allowances.

The allowance for loan losses was $287.0 million and $318.0 million at June 30, 2012 and December 31, 2011, respectively. The allowance for loan losses as a percentage of non-performing loans increased to 66.5 percent at June 30, 2012 from 65.1 percent at December 31, 2011, which was driven by lower non-performing loan balances. In addition, a mix of the loans held-for-investment portfolio changed to reflect a higher percentage of newly originated loans with better credit characteristics. The allowance for loan losses as a percentage of investment loans decreased to 4.38 percent as of June 30, 2012 from 4.52 percent as of December 31, 2011.

The following tables set forth certain information regarding the allocation of our allowance for loan losses to each loan category.

ALLOWANCE FOR LOAN LOSSES

	At June 30, 2012					
	Investment Loan Portfolio	Percent of Portfolio		Allowance Amount	Percentage to Total Allowance	
	(Dollars in thousands)					
Consumer loans:						
Residential first mortgage	$3,102,137	47.4	%	$175,716	61.2	%
Second mortgage	127,434	1.9	%	20,083	7.0	%
Warehouse lending	1,261,442	19.3	%	1,556	0.5	%
HELOC	198,228	3.0	%	17,853	6.2	%
Other	57,605	0.9	%	2,585	0.9	%
Total consumer loans	4,746,846	72.5	%	217,793	75.8	%
Commercial loans:						
Commercial real estate	1,075,015	16.4	%	58,407	20.4	%
Commercial and industrial	569,288	8.7	%	8,508	3.0	%
Commercial lease financing	159,108	2.4	%	2,292	0.8	%
Total commercial loans	1,803,411	27.5	%	69,207	24.2	%
Total consumer and commercial loans	$6,550,257	100.0	%	$287,000	100.0	%

The allowance for loan losses is considered adequate based upon management's assessment of relevant factors, including the types and amounts of non-performing loans, historical and current loss experience on such types of loans, and the current economic environment.

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The following table sets forth information regarding non-performing loans (i.e., greater than 90 days past due loans).

Non-performing loans	June 30, 2012	December 31, 2011
	(Dollars in thousands)	
Loans secured by real estate		
Consumer loans:		
Home loans - secured by first lien	$282,898	$372,514
Home loans - secured by second lien	6,147	6,236
Home equity lines of credit	4,126	7,973
Warehouse lending	28	28
Commercial loans:		
Commercial real estate	138,069	99,335
Total non-performing loans secured by real estate	431,268	486,086
Consumer loans:		
Other consumer	275	611
Commercial loans:		
Commercial and industrial	56	1,670
Total non-performing loans held in portfolio	$431,599	$488,367

In response to increasing rates of past due loans and steeply declining market values, management implemented a program to modify the terms of existing loans in an effort to mitigate losses and keep borrowers in their homes. These modification programs began in the latter months of 2008 and increased substantially in 2009 and 2010. As of June 30, 2012, we had $709.2 million in restructured loans in the loans held-for-investment portfolio, of which $133.1 million were included in non-performing loans.

Allowance for Unfunded Lending Commitments

The liability for credit losses inherent in lending-related commitments, such as letters of credit and unfunded loan commitments is included in other liabilities on the Consolidated Statements of Financial Condition. We establish the amount of this reserve by considering both historical trends and current market conditions quarterly, or more often if deemed necessary. Our liability for credit losses on unfunded lending commitments decreased by $6.8 million from December 31, 2011, to $1.4 million at June 30, 2012. When combined with our allowance for loan and lease losses, our total allowance for credit losses represented 4.4 percent of loans at June 30, 2012, compared to 4.6 percent at December 31, 2011.

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The following table shows the activity in the allowance for credit losses (include both allowance for loan losses and the reserve for unfunded commitments) during the indicated periods.

ACTIVITY WITHIN THE ALLOWANCE FOR CREDIT LOSSES

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2012	2011	2012	2011
	(Dollars in thousands)			
Allowance for Loan Losses:				
Balance, beginning of period	$281,000	$271,000	$318,000	$274,000
Provision charged to operations	58,428	48,384	173,101	76,693
Charge-offs	(62,912)	(47,265)	(217,850)	(81,384)
Recoveries	10,484	1,881	13,749	4,691
Balance, end of period	$287,000	$274,000	$287,000	$274,000
Reserve for Unfunded Commitments:				
Balance, beginning of period	$8,500	$3,750	$8,200	$3,750
Provision charged to operations	102	(450)	402	(450)
Charge-offs	(7,202)	—	(7,202)	—
Recoveries	—	—	—	—
Balance, end of period	$1,400	$3,300	$1,400	$3,300

Accrued interest receivable. Accrued interest receivable remained relatively flat with a slight increase of $1.2 million from December 31, 2011 to June 30, 2012. This was primarily due to our earning assets increasing $0.6 billion to $12.5 billion at June 30, 2012, as compared to $11.9 billion at December 31, 2011. During the three and six months ended June 30, 2012, $2.1 million and $4.5 million of accrued interest on non-performing loans was reversed against interest income. We typically collect interest in the month following the month in which it is earned.

Repossessed assets. Real property we acquire as a result of the foreclosure process is classified as real estate owned until it is sold. It is transferred from the loans held-for-investment portfolio at the lower of cost or market value, less disposal costs. Management decides whether to rehabilitate the property or sell it “as is” and whether to list the property with a broker. The decrease in repossessed assets from December 31, 2011 to June 30, 2012, was primarily due to $55.4 million in disposals during the six months ended June 30, 2012.

Recently, increased attention has been placed in the mortgage banking industry's documentation and review associated with foreclosure processes. We believe our foreclosure processes follow established safeguards and industry-leading practices, including review and implementation changes as required by agency, state and local guidelines. We routinely review our policies and procedures to reconfirm the foreclosure process quality.

The following schedule provides the activity for repossessed assets during each of the past five quarters.

NET REPOSSESSED ASSET ACTIVITY

	For the Three Months Ended				
	June 30, 2012	March 31, 2012	December 31, 2011	September 30, 2011	June 30, 2011
	(Dollars in thousands)				
Beginning balance	$108,686	$114,715	$113,365	$110,050	$146,372
Additions	24,734	23,198	26,237	21,312	16,229
Disposals	(26,185)	(29,227)	(24,887)	(17,997)	(52,551)
Ending balance	$107,235	$108,686	$114,715	$113,365	$110,050

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FHLB stock. At June 30, 2012, holdings of FHLB stock remained unchanged from $301.7 million at December 31, 2011. Once purchased, FHLB shares must be held for five years before they can be redeemed. As a member of the FHLB, we are required to hold shares of FHLB stock in an amount equal to at least 1.0 percent of aggregate unpaid principal balance of our mortgage loans, home purchase contracts and similar obligations at the beginning of each year, or 5.0 percent of our FHLB advances, whichever is greater.

Premises and equipment. Premises and equipment, net of accumulated depreciation increased $5.5 million from $203.6 million at December 31, 2011 to $209.1 million at June 30, 2012. The increase was primarily due to our investment in our mortgage loan servicing area.

Mortgage servicing rights. At June 30, 2012, MSRs included residential MSRs at fair value amounting to $638.9 million, compared to $510.5 million at December 31, 2011. During the six months ended June 30, 2012 and 2011, we recorded additions to our residential MSRs of $238.2 million and $88.9 million, respectively, due to loan sales or securitizations. Also, during the six months ended June 30, 2012, we reduced the amount of MSRs by $17.4 million related to bulk servicing sales, $56.0 million related to loans that paid off during the period and a decrease in the fair value of MSRs of $36.4 million resulting from the realization of expected cash flows and market driven changes, primarily as a result of decreases in mortgage loan rates that led to an expected increase in prepayment speeds. Consumer MSRs were eliminated during 2010 upon the transfer to a backup servicer pursuant to the applicable servicing agreements. See Note 10 of the Notes to the Consolidated Financial Statements, in Item 1. Financial Statements herein.

The principal balance of the loans underlying our total MSRs was $76.2 billion at June 30, 2012, compared to $63.8 billion at December 31, 2011, with the increase primarily attributable to loan origination activity for 2012 partially offset by our bulk servicing sales of $2.4 billion in underlying loans.

Derivatives. During the third quarter 2011, we began to write and purchase interest rate swaps to accommodate the needs of customers requesting such services. Customer-initiated activity represented 100.0 percent of total interest rate swap contracts at June 30, 2012 and December 31, 2011. Customer-initiated trading derivatives are used primarily to focus on providing derivative products to customers that enables them to manage interest rate risk exposure. Market risk from unfavorable movements in interest rates is generally economically hedged by concurrently entering into offsetting derivative contracts resulting in no net exposure to us, outside of counterparty performance. The offsetting derivative contracts generally have nearly identical notional values, terms and indices. See Note 11 of the Notes to the Consolidated Financial Statements, in Item 1. Financial Statements herein.

CUSTOMER-INITIATED DERIVATIVE FINANCIAL INSTRUMENTS

	Interest Rate Contracts (Notional Amount)			
	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2012	2011	2012	2011
	(Dollars in thousands)			
Beginning balance	$68,954	$—	$64,720	$—
Additions	49,151	—	53,704	—
Maturities/amortizations	(812)	—	(1,131)	—
Terminations	—	—	—	—
Ending balance	$117,293	$—	$117,293	$—

Liabilities

Deposits. Our deposits consist of four primary categories: retail banking, government banking, national accounts and company controlled deposits. Total retail banking accounts increased $583.1 million, or 10.6 percent to

$6.1 billion at June 30, 2012, from $5.5 billion at December 31, 2011. Retail saving and checking accounts totaled 27.8 percent of total deposits at June 30, 2012. In addition, at June 30, 2012, retail certificates of deposit totaled $3.1 billion, with an average balance of $73,960 and a weighted average cost of 1.3 percent. Money market deposits totaled $473.5 million, with an average cost of 0.5 percent. Overall, retail deposits had an average cost of deposits of 0.9 percent at June 30, 2012, compared to 1.1 percent at December 31, 2011, reflecting increases in demand, savings, and money market account balances.

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We call on local governmental agencies as an additional source for deposit funding. Government banking deposits increased $10.1 million, or 1.4 percent, to $721.2 million at June 30, 2012, from $711.1 million at December 31, 2011. These deposit accounts include $351.3 million of certificates of deposit with maturities typically less than one year and $369.9 million in checking and savings accounts at June 30, 2012.

Prior to 2010, our national accounts division garnered wholesale deposits through the use of investment banking firms. However, no new wholesale deposits were obtained in 2012. During the six months ended June 30, 2012 wholesale deposit accounts decreased by $45.5 million, or 11.8 percent, to $339.4 million at June 30, 2012, from $384.9 million at December 31, 2011. These deposits had a weighted average cost of 3.5 percent at both June 30, 2012 and December 31, 2011.

Company controlled deposits arise due to our servicing of loans for others and represent the portion of the investor custodial accounts on deposit with the Bank. These deposits do not currently bear interest. Company controlled deposits increased $685.1 million from December 31, 2011 to $1.8 billion at June 30, 2012.

We participate in the Certificates of Deposit Account Registry Service (“CDARS”) program, through which certain customer certificates of deposit (“CD”) are exchanged for CDs of similar amounts from other participating banks. This gives customers the potential to receive FDIC insurance up to $50.0 million. At June 30, 2012, $1.0 billion of total CDs were enrolled in the CDARS program, with $967.1 million originating from public entities and $55.9 million originating from retail customers. In exchange, we received reciprocal CDs from other participating banks totaling $187.6 million from public entities and $823.0 million from retail customers at June 30, 2012.

The composition of our deposits were as follows.

	Deposit Portfolio					
	June 30, 2012			December 31, 2011		
	Balance	Month End Rate (1)	Percent Of Balance	Balance	Month End Rate (1)	Percent Of Balance
	(Dollars in thousands)					
Demand accounts	$630,537	0.1 %	7.1 %	$566,817	0.2 %	7.4 %
Savings accounts	1,845,829	0.7 %	20.7 %	1,462,185	0.9 %	19.0 %
MMDA	473,510	0.5 %	5.3 %	491,708	0.6 %	6.4 %
Certificates of deposit (2)	3,126,194	1.3 %	35.0 %	2,972,258	1.4 %	38.6 %
Total retail deposits	6,076,070	0.9 %	68.1 %	5,492,968	1.1 %	71.4 %
Demand accounts	125,524	0.4 %	1.5 %	102,911	0.4 %	1.3 %
Savings accounts	244,419	0.6 %	2.7 %	205,663	0.6 %	2.7 %
Certificates of deposit	351,275	0.6 %	3.9 %	402,523	0.7 %	5.3 %
Total government deposits (3)	721,218	0.6 %	8.1 %	711,097	0.6 %	9.3 %
National accounts	339,372	3.5 %	3.8 %	384,910	3.5 %	5.0 %
Company controlled deposits (4)	1,786,187	— %	20.0 %	1,101,013	— %	14.3 %
Total deposits (5)	$8,922,847	0.8 %	100.0 %	$7,689,988	1.0 %	100.0 %

(1) This rate reflects the average rate for the deposit portfolio at the end of the noted month.

(2) The aggregate amount of certificates of deposit with a minimum denomination of $100,000 was approximately $2.1 billion at both June 30, 2012 and December 31, 2011.

(3) Government accounts include funds from municipalities and schools.

(4) These accounts represent a portion of the investor custodial accounts and escrows controlled by the Company in connection with loans serviced for others and that have been placed on deposit with the Bank.

(5) The aggregate amount of deposits with a balance over $250,000 was approximately $2.2 billion and $1.6 billion at June 30, 2012 and December 31, 2011, respectively.

FHLB advances. FHLB advances decreased $0.6 billion to $3.4 billion at June 30, 2012 from December 31, 2011. We rely upon advances from the FHLB as a source of funding for the origination or purchase of loans for sale in the secondary market and for providing duration specific short-term and medium-term financing. The outstanding balance of FHLB advances fluctuates from time to time depending on our current inventory of mortgage loans held-for-sale and the availability of lower cost funding sources such as repurchase agreements. During the six months ended June 30, 2012, we had an increase in funds available from other sources, including an increase of deposits, which reduced short-term borrowings from FHLB.

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Long-term debt. As part of our overall capital strategy, we previously raised capital through the issuance of trust-preferred securities by our special purpose financing entities formed for the offerings. The outstanding trust preferred securities mature 30 years from issuance, are callable by us after five years, and pay interest quarterly. The majority of the net proceeds from these offerings has been contributed to us as additional paid in capital and subject to regulatory limitations, and is includable as Tier 1 regulatory capital. Under these trust preferred arrangements, we have the right to defer dividend payments to the trust preferred security holders for up to five years.

On January 27, 2012, we provided notice to the U.S. Treasury exercising the contractual right to defer regularly scheduled quarterly payments of dividends, beginning with the February 2012 payment, on preferred stock issued and outstanding in connection with participation in the TARP Capital Purchase Program. Under the terms of the preferred stock, we may defer payments of dividends for up to six quarters in total without default or penalty. Concurrently, we also exercised contractual rights to defer interest payments with respect to trust preferred securities. Under the terms of the related indentures, we may defer interest payments for up to 20 consecutive quarters without default or penalty. We believe in prudent capital stewardship and will refrain from making further payments until the financial condition improves. These payments will be periodically evaluated and reinstated when appropriate, subject to provisions of the Bancorp Supervisory Agreement.

Accrued interest payable. Accrued interest payable increased to $12.3 million at June 30, 2012 from $8.7 million at December 31, 2011. This balance represents interest payments that are payable to depositors and other entities from which we borrowed funds. The balance fluctuates with the size of our interest-bearing liability portfolio and the average cost of our interest-bearing liabilities. The increase during the six months ended June 30, 2012, was primarily a result of an increase in the balance of our interest-bearing liabilities of $0.7 billion, or 5.7 percent, from $11.9 billion at December 31, 2011 to $12.6 billion at June 30, 2012. During the six months ended June 30, 2012, the average overall rate on our deposits decreased 45 basis points to 1.1 percent, from 1.6 percent during the six months ended June 30, 2011. We also experienced an 81 basis point decrease in our cost of advances from the FHLB to an average rate of 2.7 percent during the six months ended June 30, 2012, from 3.5 percent during the six months ended June 30, 2011, principally due to the restructuring of $1.0 billion in FHLB advances during the third quarter 2011.

Representation and warranty reserve (formerly known as “secondary market reserve”). We sell most of the residential first mortgage loans that we originate into the secondary mortgage market. When we sell mortgage loans, we make customary representations and warranties to the purchasers, including sponsored securitization trusts and their insurers, about various characteristics of each loan, such as the manner of origination, the nature and extent of underwriting standards applied and the types of documentation being provided. Typically, these representations and warranties are in place for the life of the loan. If a defect in the origination process is identified, we may be required to either repurchase the loan or indemnify the purchaser for losses it sustains on the loan. If there are no such defects, generally we have no liability to the purchaser for losses it may incur on such loan.

We maintain a representation and warranty reserve to account for the expected losses related to loans we might be required to repurchase (or the indemnity payments we may have to make to purchasers). The representation and warranty reserve takes into account both our estimate of expected losses on loans sold during the current accounting period, as well as adjustments to our previous estimates of expected losses on loans sold. In addition, the OCC, as part of its supervisory function, periodically reviews our representation and warranty reserve. The OCC may require us to increase our representation and warranty reserve or to recognize further losses, based on its judgment, which may be different from that of our management. The results of such reviews could have an effect on our reserves. In each case, these estimates are based on the most recent data available to us, including data from third parties, regarding demands for loan repurchases, actual loan repurchases, and actual credit losses on repurchased loans, among other factors. Provisions added to the representation and warranty reserve for current loan sales reduce our net gain on loan sales. Adjustments to our previous estimates are recorded under non-interest income in the income statement as an increase or decrease to representation and warranty reserve - change in estimate. The amount of the representation and

warranty reserve was $161.0 million at June 30, 2012 and $120.0 million at December 31, 2011.

A significant factor in the estimate of expected losses is the activity of the GSEs, including the number of loan files they review or intend to review, as well as the number of subsequent repurchase demands made by the GSEs and the percentage of those that are actually repurchased by the Bank. The majority of our loan sales have been to GSEs, which are a significant source of our current repurchase demands. These demands are concentrated in the post-2006 and pre-2009 origination years. While we have an established history of GSE demands, this pattern has recently changed, becoming more volatile in the level of demands from period to period and also increasing in the number of demands overall, thereby increasing our loss estimates. For the six months ended June 30, 2012, the amount of new repurchase demands increased to $586.1 million, compared to $400.0 million for the six months ended June 30, 2011.

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The following table summarizes the amount of quarterly new repurchase demands we have received by loan origination year.

	For the Three Months Ended				
	June 30, 2012	March 31, 2012	December 31, 2011	September 30, 2011	June 30, 2011
	(Dollars in thousands)				
2005 and prior	$25,505	$18,310	$13,228	$13,242	$22,010
2006	33,481	27,743	32,249	31,478	29,816
2007	135,888	93,410	86,993	87,146	84,407
2008	89,780	63,494	45,170	45,094	40,554
2009-2011	62,153	36,320	15,353	23,597	20,486
Total	$346,807	$239,277	$192,993	$200,557	$197,273

The following table summarizes the aggregate amount of pending repurchase demands at the end of each quarterly period noted.

	For the Three Months Ended				
	June 30, 2012	March 31, 2012	December 31, 2011	September 30, 2011	June 30, 2011
	(Dollars in thousands)				
Period end balance	$469,800	$357,377	$343,295	$349,514	$316,209
Percent non-agency (approximately)	0.6 %	1.1 %	1.9 %	2.0 %	1.7 %

For the six months ended June 30, 2012, we increased the reserve by $10.7 million for new loan sales and $106.6 million for adjustments to previous estimates of expected losses. During the six months ended June 30, 2012, we charged-off $76.3 million, net of recoveries for realized losses. The increase during the six months ended June 30, 2012, was primarily due to refinements in the estimation process, changes in behavior of GSEs and efforts to incorporate more predictive analysis into the forecasted repurchase process. For the six months ended June 30, 2011, we increased the provision $3.7 million for new loan sales and $41.8 million for adjustments to previous estimates of expected losses. During the six months ended June 30, 2011, we charged-off $45.5 million, net of recoveries for realized losses.

The following table summarizes changes in the representation and warranty reserve over the last five quarters.

	For the Three Months Ended				
	June 30, 2012	March 31, 2012	December 31, 2011	September 30, 2011	June 30, 2011
	(Dollars in thousands)				
Beginning balance	$142,000	$120,000	$85,000	$79,400	$79,400
Additions	51,670	65,589	72,761	40,781	22,739
Charge-offs	(32,670)	(43,589)	(37,761)	(35,181)	(22,739)
Ending balance	$161,000	$142,000	$120,000	$85,000	$79,400

Our enhanced first quarter 2012 model refines our previous estimates by adding granularity to the model through segmenting of the sold portfolio by vintage years and investor (generally, the GSEs) in order to assign assumptions specific to each segment. Key assumptions in the model include the number of investor audits, demand requests, appeal loss rates, loss severity, and recoveries.

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The following table summarizes the trends over the last two quarters with respect to key model attributes and assumptions for estimating the representation and warranty reserve.

	June 30, 2012	December 31, 2011
	(Dollars in Thousands)	
UPB of loans sold	$192,000,000	$175,000,000
Remaining UPB[1]	$83,000,000	$75,000,000
Loan file review as percentage of UPB	9.5 %	5.0 %
Repurchase demand rate	14.6 %	16.0 %
Actual repurchase rate (win/loss) [2]	38.1 %	42.0 %
Loss severity rate [2]	39.9 %	44.0 %
Ending reserve balance	$161,000	$120,000

(1) Includes servicing sold with recourse
(2) Weighted average

As of June 30, 2012, the total original UPB of mortgage loans we have sold to the GSEs was $192.0 billion, with a remaining UPB of $83.0 billion. We estimate, as of June 30, 2012, that approximately 9.5 percent of the remaining UPB will be reviewed, with 14.6 percent of that amount being sent back for repurchase. We also estimate that, as of June 30, 2012, we will actually repurchase 38.1 percent of the amount sent back for repurchase, at a loss severity of 39.9 percent.

Other liabilities. Other liabilities primarily consist of undisbursed payments, escrow accounts, forward agency and derivative liability and the Ginnie Mae liability resulting from the recognition of our unilateral right to repurchase certain mortgage loans currently included in Ginnie Mae securities. Other liabilities decreased at June 30, 2012, from December 31, 2011, primarily due to an $103.6 million decrease in undisbursed payments on loans serviced for others liability from $149.1 million at December 31, 2011 to $45.5 million at June 30, 2012. These amounts represent payments received from borrowers for interest, principal and related loan charges which have not been remitted to investors. Escrow accounts totaled $47.8 million and $26.3 million at June 30, 2012 and December 31, 2011, respectively. Escrow accounts are maintained on behalf of mortgage customers and include funds collected for real estate taxes, homeowners insurance and other insured product liabilities. The Ginnie Mae liability totaled $83.6 million and $117.2 million at June 30, 2012 and December 31, 2011, respectively. These amounts are for certain loans sold to Ginnie Mae, as to which we have not yet repurchased, but have the unilateral right to do so. With respect to such loans sold to Ginnie Mae, a corresponding asset was included in loans held-for-sale. For further information on our loans held-for-sale, see Note 5 of the Notes to the Consolidated Financial Statements, in Item 8. Financial Statements and Supplementary Data, herein.

Other liabilities also include the fair value of the litigation settlement with the U.S. Department of Justice ("DOJ"). On February 24, 2012, we entered into an agreement (the “DOJ Agreement”) with the DOJ relating to certain underwriting practices associated with loans insured by the FHA.

Pursuant to the material terms of the settlement with the DOJ, we made an initial payment of $15.0 million within 30 business days of the effective date of the DOJ Agreement. Upon the occurrence of certain future events (as further described below), we become obligated to make payments of approximately $118.0 million (the “Additional Payments”). The Additional Payments will occur if and only if each of the following events happen:

- We generate positive income for a sustained period, such that part or all of our Deferred Tax Asset (“DTA”), which has been offset by a valuation allowance (the “DTA Valuation Allowance”), is likely to be realized, as evidenced by the reversal of the DTA Valuation Allowance in accordance with accounting principles generally

accepted in the United States (“GAAP”);

- We are able to include capital derived from the reversal of the DTA Valuation Allowance in our Tier 1 capital; and

- Our obligation to repay the $266.7 million in preferred stock held by the U.S. Treasury under the TARP Capital Purchase Program has been either extinguished or excluded from Tier 1 capital for purposes of calculating the Tier 1 capital ratio as described in the paragraph below.

Upon the occurrence of each of the future events described above, and provided doing so would not violate any banking regulatory requirement or the OCC does not otherwise object, we will begin making Additional Payments provided that (i) each annual payment would be equal to the lesser of $25 million or the portion of the Additional Payments that remains outstanding after deducting prior payments; and (ii) no obligation arises until our call report is filed with the OCC, including any amendments

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thereto, for the period ending at least six months prior to the making of such Additional Payments, reflects a minimum Tier 1 capital ratio of 11 percent (or higher if required by regulators), after excluding any unextinguished portion of the preferred stock held by U.S. Treasury under the TARP Capital Purchase Program.

We had a total liability of $19.1 million at June 30, 2012, compared to $18.3 million at December 31, 2011, which represents the fair value of the Additional Payments as measured in accordance with ASC 820. We have elected the fair value option for the financial liability representing the future payment obligations established in the DOJ Agreement. We valued our contractual obligation to pay, utilizing a discounted cash flow model that incorporates our current estimate of the most likely timing and amount of the cash flows necessary to satisfy the obligation. These cash flow estimates are reflective of our detailed financial and operating projections for the next three years, as well as more general growth earnings and capital assumptions for subsequent periods. We discounted the cash flows using a 15.6 percent at June 30, 2012, discount rate that is inclusive of the risk free rate based on the expected duration of the liability, and an adjustment for nonperformance risk that represents our own credit risk. The recorded liability, at fair value, represents the present value of these estimated cash flows and is included in “other liabilities” on the Consolidated Financial Statements. We estimate the fair value of this liability at each measurement date and record any changes in that estimate, as well as the effect of the accretion of the fact amount of the liability, during the period in which these changes occur. The timing and value of payments to be made under the liability is largely based on our financial performance and forecasted growth assumptions. If our actual financial results, future growth rate assumptions, or our credit risks materially change, the value of the liability will also change.

Capital Resources and Liquidity

Our principal uses of funds include loan originations and operating expenses. At June 30, 2012, we had outstanding rate-lock commitments to lend $6.4 billion in mortgage loans, compared to $5.3 billion at December 31, 2011. These commitments may expire without being drawn upon and therefore, do not necessarily represent future cash requirements. Total commercial and consumer unused collateralized lines of credit totaled $1.7 billion at June 30, 2012 and $1.5 billion at December 31, 2011.

Capital. We had net income of $77.3 million during the six months ended June 30, 2012. We did not pay any cash dividends on our common stock during the six months ended June 30, 2012 or during the year ended December 31, 2011. On February 19, 2008, our board of directors suspended future dividends payable on our common stock. Under the capital distribution regulations, a savings bank that is a subsidiary of a savings and loan holding company must either notify or seek approval from the OCC of an association capital distribution at least 30 days prior to the declaration of a dividend or the approval by our board of directors of the proposed capital distribution. The 30-day period allows the OCC to determine whether or not the distribution would not be advisable. We currently must seek approval from the OCC prior to making a capital distribution from the Bank. In addition, we are prohibited from increasing dividends on our common stock above $0.05 per share without the consent of U.S. Treasury pursuant to the terms of the TARP.

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by regulators about components, risk weightings and other factors.

At June 30, 2012, the Bank was considered “well-capitalized” for regulatory purposes at June 30, 2012, and had regulatory capital ratios of 9.07 percent for the Tier 1 capital ratio (to adjusted total assets) and 17.03 percent for the total risk-based capital ratio (to risk-weighted assets). At June 30, 2012, the Company had a Tier 1 common capital ratio (to risk-weighted assets) of 9.60 percent and an equity-to-assets ratio of 8.20 percent.

We are aggressively growing our core deposits, which includes checking, savings and money market deposit accounts, base. Core deposits are a more stable funding source and their growth allows us to replace maturing brokered CDs and other potentially less stable funding sources.

Liquidity. Liquidity measures the ability to meet current and future cash flow needs as they become due. The liquidity of a financial institution reflects its ability to meet loan requests, to accommodate possible outflows in deposits and to take advantage of interest rates and market opportunities. The ability of a financial institution to meet current financial obligations is a function of the balance sheet structure, the ability to liquidate assets, and the access to various sources of funds.

We primarily originate Agency eligible loans and therefore the majority of new residential first mortgage loan originations are readily convertible to cash, either by selling them as part of our monthly agency sales, private party whole loan sales, or by pledging them to the FHLB and borrowing against them. We use the FHLB as our primary source for funding our residential

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mortgage business due to its flexibility in terms of being able to borrow or repay borrowings as daily cash needs require. We have been successful in increasing the amount of assets that qualify as eligible collateral at the FHLB and are continually working to add more. The most recent addition was a pool of commercial real estate loans that had been pledged to support our Federal Reserve Bank of Chicago discount window line of credit. While the shift did reduce our discount window line it was a positive move from an operational liquidity perspective since it increased the FHLB line which is actively used. Adding eligible collateral pools gives us added capacity and flexibility to manage our funding requirements.

The amount we can borrow, or the value we receive for the assets pledged to our liquidity providers, varies based on the amount and type of pledged collateral as well as the perceived market value of the assets and the “haircut” off the market value of the assets. That value is sensitive to the pricing and policies of our liquidity providers and can change with little or no notice.

In addition to operating expenses at a particular level of mortgage originations, our cash flows are fairly predictable and relate primarily to the funding of residential first mortgages (outflows) and then the securitization and sales of those mortgages (inflows). Our mortgage warehouse funding line of business also generates cash flows as funds are extended to correspondent relationships to close new loans. Those loans are repaid when the correspondent sells the loan. Other material cash flows relate to growing our commercial lines of business and the loans we service for others (primarily the agencies) and consist primarily of principal, interest, taxes and insurance. Those monies come in over the course of the month and are paid out based on predetermined schedules. These flows are largely a function of the size of the servicing book and the volume of refinancing activity of the loans serviced. In general, monies received in one month are paid during the following month with the exception of taxes and insurance monies that are held until such are due.

As governed and defined by our internal liquidity policy, we maintain adequate excess liquidity levels appropriate to cover both unanticipated operational and regulatory requirements. In addition to this standby liquidity, we also maintain targeted minimum levels of unused borrowing capacity as an additional cushion against unexpected liquidity needs. Each business day, we forecast 90 days of daily cash needs. This allows us to determine our projected near term daily cash fluctuations and also to plan and adjust, if necessary, future activities. As a result, we would be able to make adjustments to operations as required to meet the liquidity needs of our business, including adjusting deposit rates to increase deposits, planning for additional FHLB borrowings, accelerate loans held-for-sale loan sales (agency and or private), sell loans held-for-investment or securities, borrow using repurchase agreements, reduce originations, make changes to warehouse funding facilities, or borrowing from the discount window.

Our liquidity position is continuously monitored and adjustments are made to the balance between sources and uses of funds as deemed appropriate. Management is not aware of any events that are reasonably likely to have a material adverse effect on our liquidity, capital resources or operations.

Borrowings. The FHLB provides loans, also referred to as advances, on a fully collateralized basis, to savings banks and other member financial institutions. We are currently authorized through a resolution of our board of directors to apply for advances from the FHLB using approved loan types as collateral. At June 30, 2012, we had an authorized line of credit of $7.0 billion that could be utilized to the extent we provide sufficient collateral. At June 30, 2012, we had available collateral sufficient to access $4.1 billion of the line and as to which we had $3.4 billion of advances outstanding.

We have arrangements with the Federal Reserve Bank of Chicago to borrow as appropriate from its discount window. The discount window is a borrowing facility that is intended to be used only for short-term liquidity needs arising from special or unusual circumstances. The amount we are allowed to borrow is based on the lendable value of the collateral that we provide. To collateralize the line, we pledge commercial and industrial loans that are eligible based

on Federal Reserve Bank of Chicago guidelines. At June 30, 2012, we had pledged commercial and industrial loans amounting to $87.5 million with a lendable value of $60.0 million. At December 31, 2011, we had pledged commercial and industrial loans amounting to $69.7 million with a lendable value of $32.6 million. At June 30, 2012 and December 31, 2011, we had no borrowings outstanding against this line of credit.

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Critical Accounting Policies

Various elements of our accounting policies, by their nature, are inherently subject to estimation techniques, valuation assumptions and other subjective assessments. Certain accounting policies that, due to the judgment, estimates and assumptions inherent in those policies, are critical to an understanding of our consolidated financial statements. These policies relate to: (a) fair value measurements; (b) the determination of our allowance for loan losses; and (c) the determination of our representation and warranty reserve. We believe the judgment, estimates and assumptions used in the preparation of our consolidated financial statements are appropriate given the factual circumstances at the time. However, given the sensitivity of our consolidated financial statements to these critical accounting policies, the use of other judgments, estimates and assumptions could result in material differences in our results of operations and/or financial condition. For further information on our critical accounting policies, please refer to our Annual Report on Form 10-K for the year ended December 31, 2011, which is available on our website, www.flagstar.com, under the Investor Relations section, or on the website of the Securities and Exchange Commission, at www.sec.gov.

Derivative instruments are carried at fair value in either “other assets” or “other liabilities” on the Consolidated Statements of Financial Condition. The accounting for changes in the fair value (i.e., gains or losses) of a derivative instrument is determined by whether it has been designated and qualifies as part of a hedging relationship and, further, by the type of hedging relationship. For derivative instruments not designated as hedging instruments, the gain or loss is recognized in current earnings during the period of change. See Note 11 of the Notes to the Consolidated Financial Statements, in Item 1. Financial Statements herein.

Allowance for Loan Losses

As part of our ongoing risk assessment process which remains focused on the impacts of the current economic environment and the related borrower repayment behavior on our credit performance, management continues to back test and validate the results of quantitative and qualitative modeling of the risk in loans held-for-investment portfolio in efforts to utilize the best quality information available. Such is consistent with the expectations of the Bank's primary regulator and a continuing evaluation of the performance dynamics within the mortgage industry. As a result of an analysis completed during the first quarter 2012, we determined it was necessary to make refinements to our allowance for loan loss methodology and related model. Such refinements included improved risk segmentation and quantitative analysis and modeling, and enhancements and alignment of the qualitative risk factors.

Accounting standards require a reserve to be established as a component of the allowance for loan losses when it is probable all amounts due will not be collected pursuant to the contractual terms of the loan and the recorded investment in the loan exceeds its fair value. Fair value is measured using either the present value of the expected future cash flows discounted at the loan's effective interest rate, the observable market price of the loan, or the fair value of the collateral if the loan is collateral dependent, reduced by estimated disposal costs.

Nonperforming commercial and commercial real estate loans are considered to be impaired and typically have an allowance allocated based on the underlying collateral's appraised value, less management's estimates of costs to sell. In estimating the fair value of collateral, we utilize outside fee based appraisers to evaluate various factors such as occupancy and rental rates in our real estate markets and the level of obsolescence that may exist on assets acquired from commercial business loans. Appraisals are updated at least annually but may be obtained more frequently if changes to the property or market conditions warrant.
Impaired residential loans include loan modifications considered to be TDRs and certain nonperforming loans that have been charged-down to collateral value. Fair value of nonperforming residential mortgage loans, including redefaulted TDRs and certain other severely past due loans, is based on the underlying collateral's value obtained through appraisals or broker's price opinions, updated at least semi-annually, less management's estimates of cost to sell. The allowance allocated to TDRs performing under the terms of their modification is typically based on the

present value of the expected future cash flows discounted at the loan's effective interest rate, either on a loan level or pooled basis, as these loans are not considered to be collateral dependent.

For those loans not individually evaluated for impairment, management has sub-divided the commercial and consumer loans into homogeneous portfolios.

The following key refinements were made:
First, we utilized refined segmentation and more formal qualitative factors during the first quarter 2012, which resulted in an increase in the adjusted historical factors used to calculate the ASC 450-20 allowance related to the consumer portfolio. Historically, we segmented the population of consumer loans held-for-investment (“LHFI”) by product type and by delinquency status for purposes of estimating an adequate allowance for loan losses. Management performed a thorough analysis of the largest

product type, residential first mortgage loans, to assess the relative reliability of its risk segmentation in connection with the ability to detect losses inherent in the portfolio, and determined that there was a higher correlation of loan losses to LTV ratios than to delinquency status. As a result, management refined its process to use LTV segmentation, rather than product and delinquency segmentation, as the more appropriate consumer residential loan characteristic in determining the related allowance for loan losses.

Additionally, we created a more formal process and framework surrounding the qualitative factors and better aligned the factors with regulatory guidance and the changes in the mortgage environment. Management formally implemented a qualitative factor matrix related to each loan class in the consumer portfolio in the first quarter 2012, which includes the following factors: changes in lending policies and procedures, changes in economic and business conditions, changes in the nature and volume of the portfolio, changes in lending management, changes in credit quality statistics, changes in the quality of the loan review system, changes in the value of underlying collateral for collateral-dependent loans, changes in concentrations of credit, and other external factor changes. These factors are used to reflect changes in the collectability of the portfolio not captured by the historical loss rates. As such, the qualitative factors supplement actual loss experience and allow us to better estimate the loss within the loan portfolios based upon market and other indicators. Qualitative factors are analyzed to determine a quantitative impact of each factor which adjusts the historical loss rate. Adjusted historical loss rates are then used in the calculation of the allowance for loan losses. The adjusted historical loss rates at March 31, 2012 were higher than those used in the calculation of the consumer allowance for loan losses at December 31, 2011, thereby resulting in an increase to the 2012 level of allowance for loan losses.

Second, to allow us the appropriate amount of time to analyze portfolio statistics and allow for the appropriate validation of the reasonableness of the new qualitative factors, management adjusted the historical look back period for loss rates to lag a quarter (as compared to the previous policy of a month). This adjustment resulted in a decrease to the 2012 level of allowance for loan losses, as compared to the 2011 level of allowance for loan losses, partially offsetting the increase resulting from the refined segmentation.

Third, the commercial loan portfolio was segmented into commercial “legacy” loans (loans originated prior to January 1, 2011) and commercial “new” loans (loans originated on or after January 1, 2011) while still retaining the segmentation by product type. Due to the changes in our strategy and to changes in underwriting and origination practices and controls related to that strategy, management determined the refined segmentation better reflected the dynamics in the two portfolios. The loss rates attributed to the “legacy” portfolio are based on historical losses of this segment. Due to the brief period of time that loans in the “new” portfolio were outstanding, and thus the absence of a sufficient loss history for that portfolio, we had used loss data from a third party data aggregation firm (adjusting for our qualitative factors) as a proxy for estimating an allowance for loan losses on the “new” portfolio. As a refinement in the first quarter 2012, we separately identified a population of commercial banks with similar size balance sheets (and loan portfolios) to serve as our peer group. We now use this peer group's publicly available historical loss data (adjusted for our qualitative factors) as a new proxy for loss rates used to determine the allowance for loan losses on our “new” commercial portfolio. This refined segmentation resulted in an increase to the 2012 level of allowance for loan losses, as compared to the 2011 level of allowance for loan losses.

Fourth, as a result of these refinements (in addition to the refinements noted below), management has determined that it no longer requires an unallocated portion of allowance for loan losses. Management expects to review these models on an ongoing basis and update them as appropriate to reflect then-current industry conditions, heightened access to enhanced loss data, and refinements based upon continuous back testing of the allowance for loan losses model. This change to the unallocated reserve resulted in a decrease to the 2012 level of allowance for loan losses, as compared to the 2011 level of allowance for loan losses.

Lastly, part of the increase in allowance for loan losses was a result of the TDR refinement. Historically, we performed impairment analysis on TDRs by using the discounted cash flows method on a portfolio or pooled approach when the TDRs were not deemed collateral dependent. During the fourth quarter 2011, management adopted a strategic focus that improved loss mitigation processes so that we could continue the rate of loan modifications and other loss mitigation activities. Due to the emphasis on loss mitigation activities, management implemented new procedures relating to “new” TDRs (loans that were designated TDRs generally beginning on or after October 1, 2011) to capture the necessary data to perform the impairment analysis on a portfolio level. Such data was not previously available and currently continues to not be available for loans designated as TDRs prior to September 30, 2011. This data is now being captured in part due to our loan servicing system conversion in late 2011. As such, for a significant percentage of “new” TDRs, management was able to perform the impairment calculation on a portfolio basis. Given data constraints the “old” TDR portfolio as of December 31, 2011, is still utilizing the pooled approach. This refinement resulted in an increase to the 2012 level of allowance for loan losses, as compared to the 2011 level of allowance for loan losses. Management expects to continue to refine this process for operational efficiency purposes that will allow for periodic review and updates of impairment data of all TDRs grouped by similar risk characteristics.

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Use of Non-GAAP Financial Measures

In addition to results presented in accordance with GAAP, this report includes non-GAAP financial measures such as pre-tax pre-credit-cost income, the efficiency ratio and the ratio of total nonperforming assets to Tier 1 capital and general reserves. We believe these non-GAAP financial measures provide additional information that is useful to investors in helping to understand the underlying performance and trends of our unique business model. Such measures also help investors to facilitate performance comparisons and benchmarks with other bank and thrift peers in our industry.

Non-GAAP financial measures have inherent limitations, that are not required to be uniformly applied and are not audited. Readers should be aware of these limitations and should be cautious with respect to the use of such measures. To mitigate these limitations, we have procedures in place to ensure that these measures are calculated using the appropriate GAAP or regulatory components in their entirety and to ensure that our performance is properly reflected to facilitate consistent period-to-period comparisons. Although we believe the non-GAAP financial measures disclosed in this report enhance investors' understanding of our business and performance, these non-GAAP measures should not be considered in isolation, or as a substitute for those financial measures prepared in accordance with GAAP.

Pre-tax pre-credit-cost income. Pre-tax pre-credit-cost income, as defined by our management, represents net income before taxes, and excludes credit related expenses (defined by management as provision for loan losses, asset resolution expense, other than temporary impairment, representation and warranty reserve provision, write down of residual and transferors' interest and reserve increases for our reinsurance subsidiary). While these items represent an integral part of our banking operations, in each case, the excluded items are items that management believes are particularly impacted or increased due to economic stress or significant changes in the credit cycle and are therefore likely to make it more difficult to understand our underlying performance trends and our ability to generate income from our mortgage and banking operations. Net interest income, non-interest income and non-interest expense are all calculated in accordance with GAAP and are presented in the Consolidated Statements of Operations. Net income is adjusted only for the specific items listed above in the calculation of pre-tax pre-credit-cost income, and these adjustments represent the excluded items in their entirety for each period presented to better facilitate period to period comparisons.

Viewed together with our GAAP results, management believes pre-tax pre-credit cost income provides investors and stakeholders with a functional measurement to evaluate and better understand trends in our period to period ability to generate income and capital to offset credit related expenses, in each case exclusive of the effects of past and current economic stress and the credit cycle. As recent results for the banking industry demonstrate, provisions for loan losses, increases in representation and warranty reserve, asset impairments and mark-downs and expenses related to the resolution and disposition of assets can vary significantly from period to period, making a measure that helps isolate the impact of those credit related expenses on profitability integral to helping investors understand the business model. The “Asset Resolution,” “Quality of Earning Assets,” and “Representation and Warranty Reserve” sections of this report isolate the different credit quality challenges and issues and the impact of the associated credit related expenses on our income statement.

Like all non-GAAP measurements, pre-tax pre-credit-cost income usefulness is inherently limited. Because our calculation of pre-tax pre-credit-cost income may differ from the calculation of similar measures used by other bank and thrift holding companies, pre-tax pre-credit-cost income should be used to determine and evaluate period to period trends in our performance, rather than in comparison to other similar non-GAAP measurements utilized by other companies. In addition, investors should keep in mind that income tax expense (benefit), the provision for loan losses, and the other items excluded from income and expenses in the pre-tax pre-credit cost income calculation are recurring and integral expenses to our operations, and that these expenses will still accrue under GAAP, thereby reducing

GAAP earnings and, ultimately, shareholders' equity.

Efficiency ratio and efficiency ratio (credit-adjusted). The efficiency ratio, which generally measures the productivity of a bank, is calculated as non-interest expense divided by total operating income. Total operating income include net interest income and total non-interest income. Management utilizes the efficiency ratio to monitor its own productivity and believes the ratio provides investors with a meaningful tool to monitor period to period productivity trends.

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Under the efficiency ratio (credit adjusted), non-interest expense (GAAP) is presented excluding asset resolution expense to arrive at adjusted non-interest expense (non-GAAP), which is the numerator for the efficiency ratio. Non-interest income (GAAP) is presented excluding representation and warranty reserve - change in estimate to arrive at adjusted non-interest income (non-GAAP), which is included in the denominator for the efficiency ratio. As the provision for loan losses is already excluded by the ratio's own definition, we believe that the exclusion of asset resolution expense and representation and warranty reserve - change in estimate provides investors with a more complete picture of our productivity and ability to generate operating income. The efficiency ratio (credit adjusted) provides investors with a meaningful base for period to period comparisons, which management believes will assist investors in analyzing our operating results and predicting future performance. These non-GAAP financial measures are also utilized internally by management to assess the performance of our own business.

Our calculations of the efficiency ratio may differ from the calculation of similar measures used by other bank and thrift holding companies, and should be used to determine and evaluate period to period trends in our performance, rather than in comparison to other similar non-GAAP measurements utilized by other companies. In addition, investors should keep in mind that the items excluded from income and expenses in the efficiency ratio (credit adjusted) are recurring and integral expenses to our operations, and that these expenses will still accrue under similar GAAP measures.

Non-performing assets / Tier 1 + Allowance for Loan Losses. The ratio of non-performing assets to Tier 1 and allowance for loan losses divides the total level of non-performing assets held for investment by Tier 1 capital, as defined by bank regulations, plus allowance for loan losses. We believe these measurements are meaningful measures of capital adequacy used by investors, regulators, management and others to evaluate the adequacy of capital in comparison to other companies in the industry.

Tier 1 Common. The ratio of Tier 1 common is a financial measure utilized by investors, analysts and bank regulatory agencies to assess the capital position of financial services companies. Management reviews Tier 1 common along with other measures of capital as part of financial analysis and has included the non-GAAP measurement, and the corresponding reconciliation to Tier 1 capital because of current interest in such information on the part of market participants. Under the regulatory guidelines for risk-based capital, on-balance sheet assets and credit equivalent amounts of derivatives and off-balance sheet items are assigned to one of several broad risk categories according to the obligor or, if relevant, the guarantor or the nature of any collateral. The aggregate dollar amount in each risk category is then multiplied by the risk weight associated with that category. The resulting weighted values from each of the risk categories are aggregated for determining total risk-weighted assets.

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The following table displays the calculation for the non-GAAP measures.

Non-GAAP Reconciliation
(Dollars in thousands)
(Unaudited)

	For the Three Months Ended					For the Six Months Ended	
	June 30, 2012	March 31, 2012	December 31, 2011	September 30, 2011	June 30, 2011	June 30, 2012	June 30, 2011
Pre-tax, pre-credit-cost income							
Income (loss) before tax provision	$87,887	$(7,309)	$(74,901)	$(9,216)	$(69,904)	$80,577	$(96,605)
Add back:							
Provision for loan losses	58,428	114,673	63,548	36,690	48,384	173,101	76,693
Asset resolution	20,851	36,770	32,408	34,515	23,282	57,621	61,391
Other than temporary impairment on available-for-sale investments	1,017	1,175	7,132	1,322	15,584	2,192	15,584
Representation and warranty reserve provision	46,028	60,538	69,279	38,985	21,364	106,566	41,791
Write down of residual interest	1,244	409	847	186	2,258	1,653	4,640
Total credit-related-costs	127,568	213,565	173,214	111,698	110,872	341,133	200,099
Pre-tax, pre-credit-cost income	$215,455	$206,256	$98,313	$102,482	$40,968	$421,710	$103,494
Efficiency ratio (credit-adjusted)							
Net interest income (a)	$75,478	$74,733	$75,863	$65,614	$51,324	$150,211	$103,897
Non-interest income (b)	240,334	221,377	118,621	112,551	58,078	461,710	154,344
Representation and warranty reserve - change in estimate (c)	46,028	60,538	69,279	38,985	21,364	106,566	41,791
Adjusted income	$361,840	$356,648	$263,763	$217,150	$130,766	$718,487	$300,032
Non-interest expense (d)	169,497	188,746	205,837	150,691	130,922	358,243	278,153
Asset resolution expense (e)	(20,581)	(36,770)	(32,408)	(34,515)	(23,282)	(57,621)	(61,391)
Adjusted non-interest expense	$148,916	$151,976	$173,429	$116,176	$107,640	$300,622	$216,762
Efficiency ratio (d/(a+b))	53.7 %	63.7 %	105.8 %	84.6 %	119.7 %	58.5 %	107.7 %
Efficiency ratio (credit-adjusted) ((d-e)/((a+b)+c)))	41.2 %	42.6 %	65.8 %	53.5 %	82.3 %	41.8 %	72.2 %

June 30, 2012 June 30, 2011

		December 31, 2011	
Non-performing assets / Tier 1 capital + allowance for loan losses			
Non-performing assets	$538,834	$603,082	$513,431
Tier 1 capital (1)	$1,295,962	$1,215,220	$1,267,885
Allowance for loan losses	287,000	318,000	274,000
Tier 1 capital + allowance for loan losses	$1,582,962	$1,533,220	$1,541,885
Non-performing assets / Tier 1 capital + allowance for loan losses	34.0 %	39.3 %	33.3 %
Tier 1 common			
Tier 1 capital (1)	$1,295,962	$1,215,220	$1,267,885
Adjustments			
Preferred stock	(266,657)	(266,657)	(266,657)
Qualifying trust preferred securities	(240,000)	(240,000)	(240,000)
Tier 1 common	$789,305	$708,563	$761,228
Total risk-weighted assets (2)	$8,224,348	$7,905,062	$6,870,929
Tier 1 common ratio	9.60 %	8.96 %	11.08 %

(1) Represents Tier 1 capital for Bank.

(2) Under the regulatory guidelines for risk-based capital, on-balance sheet assets and credit equivalent amounts of derivatives and off-balance sheet items are assigned to one of several broad risk categories according to the obligor or, if relevant, the guarantor or the nature of any collateral. The aggregate dollar amount in each risk category is then multiplied by the risk weight associated with that category. The resulting weighted values from each of the risk categories are aggregated for determining total risk-weighted assets.

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Item 3. Quantitative and Qualitative Disclosures about Market Risk

Market risk is the risk of loss arising from adverse changes in the fair value of financial instruments due to changes in interest rates, currency exchange rates, or equity prices. We do not have any material foreign currency exchange risk or equity price risk. The primary market risk is interest rate risk and results from timing differences in the repricing of our assets and liabilities, changes in the relationships between rate indices, and the potential exercise of explicit or embedded options.

Interest rate risk is managed by the asset liability committee (“ALCO”), which is composed of several of our executive officers and other members of management, in accordance with policies approved by our board of directors. The ALCO formulates strategies based on appropriate levels of interest rate risk. In determining the appropriate level of interest rate risk, the ALCO considers the impact projected interest rate scenarios have on earnings and capital, liquidity, business strategies, and other factors. The ALCO meets monthly or as deemed necessary to review, among other things, the sensitivity of assets and liabilities to interest rate changes, the book and fair values of assets and liabilities, unrealized gains and losses, purchase and sale activity, loans held-for-sale and commitments to originate loans, and the maturities of investments, borrowings and time deposits.

Financial instruments used to manage interest rate risk include financial derivative products such as interest rate swaps and forward sales commitments. Further discussion of the use of and the accounting for derivative instruments is included in Notes 4 and 11 of the Notes to Consolidated Financial Statements, in Item 1 Financial Statements and Supplementary Data, herein. All of our derivatives are accounted for at fair market value. All mortgage loan production originated for sale is accounted for on a fair value basis.

To effectively measure and manage interest rate risk, sensitivity analysis is used to determine the impact on net market value of various interest rate scenarios, balance sheet trends, and strategies. From these simulations, interest rate risk is quantified and appropriate strategies are developed and implemented. Additionally, duration and net interest income sensitivity measures are utilized when they provide added value to the overall interest rate risk management process. The overall interest rate risk position and strategies are reviewed by executive management and board of directors on an ongoing basis. Business is traditionally managed to reduce overall exposure to changes in interest rates. However, management has the latitude to increase interest rate sensitivity position within certain limits if, in management's judgment, the increase will enhance profitability.

In the past, the savings and loan industry measured interest rate risk using gap analysis. Gap analysis is one indicator of interest rate risk; however it only provides a glimpse into expected asset and liability repricing in segmented time frames. Today the banking industry utilizes the concept of Net Portfolio Value (“NPV”). NPV analysis provides a fair value of the balance sheet in alternative interest rate scenarios. The NPV does not take into account management intervention and assumes the new rate environment is constant and the change is instantaneous.

The following table is a summary of the changes in our NPV that are projected to result from hypothetical changes in market interest rates. NPV is the market value of assets, less the market value of liabilities, adjusted for the market value of off balance sheet instruments. The interest rate scenarios presented in the table include interest rates at June 30, 2012 and December 31, 2011 and as adjusted by instantaneous parallel rate changes upward to 300 basis points and downward to 100 basis points. The scenarios are not comparable due to differences in the interest rate environments, including the absolute level of rates and the shape of the yield curve. Each rate scenario reflects unique prepayment, repricing, and reinvestment assumptions. Management derives these assumptions by considering published market prepayment expectations, the repricing characteristics of individual instruments or groups of similar instruments, our historical experience, and our asset and liability management strategy. Further, this analysis assumes that certain instruments would not be affected by the changes in interest rates or would be partially affected due to the characteristics of the instruments.

This analysis is based on our interest rate exposure at June 30, 2012 and December 31, 2011, and does not contemplate any actions that we might undertake in response to changes in market interest rates, which could impact NPV. Further, as this framework evaluates risks to the current statement of financial condition only, changes to the volumes and pricing of new business opportunities that can be expected in the different interest rate outcomes are not incorporated in this analytical framework. For instance, analysis of our history suggests that declining interest rate levels are associated with higher loan production volumes at higher levels of profitability. While this "natural business hedge" historically offset most, if not all, of the identified risks associated with declining interest rate scenarios, these factors fall outside of the net portfolio value framework. Further, there can be no assurance that this natural business hedge would positively affect the net portfolio value in the same manner and to the same extent as in the past.

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There are limitations inherent in any methodology used to estimate the exposure to changes in market interest rates. It is not possible to fully model the market risk in instruments with leverage, option, or prepayment risks. Also, we are affected by basis risk, which is the difference in repricing characteristics of similar term rate indices. As such, this analysis is not intended to be a precise forecast of the effect a change in market interest rates would have on us.

While each analysis involves a static model approach to a dynamic operation, the NPV model is the preferred method. If NPV increases in any interest rate scenario, that would indicate an increasing direction for the margin in that hypothetical rate scenario. A perfectly matched balance sheet would possess no change in the NPV, no matter what the rate scenario. The following table presents the NPV in the stated interest rate scenarios (dollars in millions).

June 30, 2012					December 31, 2011				
Scenario	NPV	NPV%	$ Change	% Change	Scenario	NPV	NPV%	$ Change	% Change
300	$921	6.8 %	$(247)	(21.2)%	300	$896	7.0 %	$(184)	(17.0)%
200	$1,064	7.7 %	$(104)	(8.9)%	200	$1,004	7.6 %	$(76)	(7.0)%
100	$1,162	8.2 %	$(6)	(0.5)%	100	$1,082	8.1 %	$1	0.1 %
Current	$1,168	8.2 %	$—	— %	Current	$1,080	8.0 %	$—	— %
(100)	$1,072	7.5 %	$(96)	(8.2)%	(100)	$964	7.1 %	$(116)	10.7 %

Our balance sheet exhibits minimal sensitivity for fairly small rate movements. The negative convexity of our balance sheet leads more sensitivity in larger rate movements. The amount of price sensitivity tends to decrease as rates rise and increase as rates fall. Negative convexity is a measure of the sensitivity of the duration to changes in interest rates.

Item 4. Controls and Procedures

(a) Disclosure Controls and Procedures. A review and evaluation was performed by our principal executive and financial officers regarding the effectiveness of our disclosure controls and procedures as of June 30, 2012 pursuant to Rule 13a-15(b) of the Securities Exchange Act of 1934, as amended. Based on that review and evaluation, the principal executive and financial officers have concluded that our current disclosure controls and procedures, as designed and implemented, are operating effectively.

(b) Changes in Internal Controls. During the quarter ended June 30, 2012, there has been no change in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) of the Securities Exchange Act of 1934, as amended, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II
Item 1. Legal Proceedings
From time to time, the Company is party to legal proceedings incident to its business. See Note 20 of the Notes to Consolidated Financial Statements, in Item 1 Financial Statements and Supplementary Data, which is incorporated herein by
reference herein.
Item 1A. Risk Factors

There have been no material changes to the risk factors previously disclosed in response to Item 1A to Part I of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2011, except the following risk factors that update and supplement the risk factors in that report.

We and the Bank are subject to the restrictions and conditions of the Supervisory Agreements imposed by the OTS. The change to the OCC and the Federal Reserve as the Bank's and our primary federal regulators may result in enforcement actions different than or in addition to those of the Supervisory Agreements based upon their discretionary authority and their respective interpretations of the underlying issues. Such enforcement actions could negatively affect our results of operations and financial condition.

We and the Bank are subject to the Supervisory Agreements, which require that we and the Bank separately take certain actions to address issues identified by the OTS, as further described in our Current Report on Form 8-K filed with the SEC on January 28, 2010. As a consequence of the Dodd-Frank Wall Street Reform and Consumer Protection Act's elimination of the OTS, the Bank's primary federal regulator is the OCC and our primary federal regulator is the Federal Reserve. The OCC and the Federal Reserve each has the authority to impose enforcement actions different than or in addition to those of the Supervisory Agreements based upon their discretionary authority and their respective interpretations of the underlying issues. Since the OCC became the primary federal regulator of the Bank and other federal savings banks, there have been various examples of the OCC imposing formal enforcement actions, which could include written agreements, orders, capital directives and prompt corrective action directives, that include a requirement for the federal savings bank to achieve and thereafter maintain specified minimum capital ratios. Under applicable regulations, the requirement in these formal enforcements actions to meet and maintain a specific capital level precludes the federal savings bank from being deemed to be “well capitalized,” even if the federal savings bank otherwise meets the minimum capital ratios to qualify as “well capitalized.” If the OCC imposes on the Bank a formal enforcement action that requires the Bank to meet and maintain a specific capital level and thus precludes the Bank from being deemed to be "well-capitalized," such a formal enforcement action could have a material adverse effect on our operating results and liquidity.

Certain hedging strategies that we use to manage investment in MSRs may be ineffective to offset any adverse changes in the fair value of these assets due to changes in interest rates and market liquidity.

We invest in MSRs to support mortgage banking strategies and to deploy capital at acceptable returns. We also deploy derivatives and other fair value assets as economic hedges to offset changes in fair value of the MSRs resulting from the actual or anticipated changes in prepayments stemming from changing interest rate environments. The primary risk associated with MSRs is that they will lose a substantial portion of their value as a result of higher than anticipated prepayments due to loan refinancing prompted, in part, by declining interest rates. Conversely, these assets generally increase in value in a rising interest rate environment to the extent that prepayments are slower than anticipated. There is also a risk of valuation decline due to higher than expected increases in default rates, but we do not believe such risk can be sufficiently quantified to effectively hedge. Our hedging strategies are highly susceptible to prepayment risk, basis risk, market volatility and changes in the shape of the yield curve, among other factors. In addition, hedging strategies rely on assumptions and projections regarding assets and general market factors. If these assumptions and projections prove to be incorrect or our hedging strategies do not adequately mitigate the impact of

changes in interest rates or prepayment speeds, we may incur losses that would adversely impact earnings.

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Item 2. Unregistered Sales of Equity Securities and Use of Proceeds
Sale of Unregistered Securities

The Company made no sales of unregistered securities during the quarter ended June 30, 2012.

Issuer Purchases of Equity Securities

The Company made no purchases of equity securities common stock during the quarter ended June 30, 2012.

Item 3. Defaults upon Senior Securities

Under the terms of the Fixed Rate Cumulative Perpetual Preferred Stock, Series C (the "Series C Preferred Stock"), issued and outstanding in connection with the TARP Capital Purchase Program, the Company may defer payments of dividends for up to six quarters without default or penalty. Beginning with the February 2012 payment, the Company has exercised its contractual right to defer regularly scheduled quarterly payments of dividends on its Series C Preferred Stock, and is therefore currently in arrears with the dividend payments. As of the date of filing this report, the amount of the arrearage on the dividend payments of the Series C Preferred Stock is $6.7 million.

Item 4. Mine Safety Disclosures

None.

Item 5. Other Information

The Company has set the date of its 2012 Annual Meeting of Stockholders for September 24, 2012 (the "2012 Annual Meeting"), which is greater than 30 days from the one-year anniversary of the date of the Company's 2011 Annual Meeting of Stockholders. As such, the Company has extended the deadline for the submission of stockholder proposals for the 2012 Annual Meeting. Stockholders who intend to present proposals at the 2012 Annual Meeting, and who wish to have those proposals included in the Company's proxy statement for the 2012 Annual Meeting, must ensure that those proposals are received by the Company's Secretary at 5151 Corporate Drive, Troy, Michigan 48098 on or before August 23, 2012, which the Company has determined to be a reasonable time before it begins to print and mail its proxy materials. In order to be included in the proxy statement, these proposals must comply with applicable law and regulations, including SEC Rule 14a-8, as well as the Company's Amended and Restated Articles of Incorporation (the "Articles").

In addition, under the Articles, stockholders who intend to submit nominations for new directors or proposals for new business at the 2012 Annual Meeting, and who do not intend to have these proposals included in the Company's proxy statement and form of proxy relating to the 2012 Annual Meeting pursuant to SEC regulations, must provide written notice of any such proposal to the Secretary at the address specified above on or before August 25, 2012. These proposals must comply with the Articles in order to be considered at the 2012 Annual Meeting.

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Item 6. Exhibits

Exhibit No.	Description
31.1	Section 302 Certification of Chief Executive Officer
31.2	Section 302 Certification of Chief Financial Officer
32.1	Section 906 Certification, as furnished by the Chief Executive Officer
32.2	Section 906 Certification, as furnished by the Chief Financial Officer
101 *	Financial statements from Quarterly Report on Form 10-Q of the Company for the quarter ended June 30, 2012, formatted in XBRL: (i) the Consolidated Statements of Financial Condition, (ii) the Consolidated Statements of Operations, (iii) the Consolidated Statements of Comprehensive Income (Loss), (iv) the Consolidated Statements of Stockholders' Equity, (v) the Consolidated Statements of Cash Flows and (vi) the Notes to the Consolidated Financial Statements.

* As provided in Rule 406T of Regulation S-T, this information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934.

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SIGNATURES

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

FLAGSTAR BANCORP, INC.
Registrant

Date: August 9, 2012

/s/ Joseph P. Campanelli
Joseph P. Campanelli
Chairman of the Board, President and
Chief Executive Officer
(Principal Executive Officer)

/s/ Paul D. Borja
Paul D. Borja
Executive Vice President and
Chief Financial Officer
(Principal Financial and Accounting Officer)

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EXHIBIT INDEX

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* As provided in Rule 406T of Regulation S-T, this information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934.

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0.2%

24,140

24,566

0.7%
Valley Electric
Holdings I, Inc.(35)
Washington / Construction & Engineering
Senior Secured Note to Valley Electric Co. of Mt. Vernon, Inc. (8.00% (LIBOR + 5.00% with 3.00% LIBOR floor) plus 2.50% PIK, due 12/31/2017)(3)(4)
10,081

10,081

10,081

0.3%
Senior Secured Note to Valley Electric Company, Inc. (10.00% plus 8.5% PIK, due 12/31/2018)
20,500

20,500

20,500

0.6%
Common Stock of Valley Electric Holdings I, Inc. (100 shares)

26,279

2,975

—%

56,860

33,556

0.9%
Wolf Energy
Holdings Inc.(12)
Kansas / Oil & Gas Production
Senior Secured Promissory Note to Wolf Energy, LLC secured by assets formerly owned by H&M (18.00%, in non-accrual status effective 4/15/2013, due 4/15/2018)(37)
22,000

—

3,386

0.1%
Senior Secured Note to Appalachian Energy LLC (8.00%, in non-accrual status effective 1/19/2010, past due)(6)
2,865

2,000

—

—%
Senior Secured Note to Appalachian Energy LLC (8.00%, in non-accrual status, past due)(6)
56

50

—

—%
Senior Secured Note to Coalbed, LLC (8.00%, in non-accrual status effective 1/19/2010, past due)(6)
8,595

5,991

—

—%
Common Stock of Wolf Energy Holdings Inc.
(100 shares)

—

—

—%
Net Profits Interest in Wolf Energy, LLC (8% of Equity Distributions)(7)

—

213

—%

8,041

3,599

0.1%
Total Control Investments

$
1,719,242

$
1,640,454

45.3%

See notes to consolidated financial statements.
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PROSPECT CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED SCHEDULES OF INVESTMENTS (CONTINUED)
(in thousands, except share data)

Portfolio Company	Locale / Industry	Investments(1)	June 30, 2014 Principal Value	Cost	Fair Value(2)	% of Net Assets
LEVEL 3 PORTFOLIO INVESTMENTS						
Affiliate Investments (5.00% to 24.99% voting control)(52)						
BNN Holdings Corp.	Michigan / Healthcare	Senior Secured Note (10.00% (LIBOR + 8.00% with 2.00% LIBOR floor), due 12/17/2017)(3)(4)	$28,950	$28,950	$28,950	0.8%
		Series A Preferred Stock (9,925.455 shares)(13)		2,300	2,614	0.1%
		Series B Preferred Stock (1,753.636 shares)(13)		579	557	—%
				31,829	32,121	0.9%
Total Affiliate Investments				$31,829	$32,121	0.9%

Non-Control/Non-Affiliate Investments (less than 5.00% voting control)

Portfolio Company	Locale / Industry	Investments(1)	Principal Value	Cost	Fair Value(2)	% of Net Assets
Aderant North America, Inc.	Georgia / Software & Computer Services	Second Lien Term Loan (10.00% (LIBOR + 8.75% with 1.25% LIBOR floor), due 6/20/2019)(4)(16)	$7,000	$6,914	$7,000	0.2%
				6,914	7,000	0.2%
Aircraft Fasteners International, LLC	California / Machinery	Class A Units (32,500 units)		396	505	—%
				396	505	—%
ALG USA Holdings, LLC	Pennsylvania / Hotels, Restaurants & Leisure	Second Lien Term Loan (10.25% (LIBOR + 9.00% with 1.25% LIBOR floor), due 2/28/2020)(4)(16)	12,000	11,792	12,000	0.3%
				11,792	12,000	0.3%
Allied Defense Group, Inc.	Virginia / Aerospace & Defense	Common Stock (10,000 shares)		5	—	—%
				5	—	—%
American Broadband Holding Company and Cameron Holdings of NC, Inc.	North Carolina / Telecommunication Services	Senior Secured Term Loan B (11.00% (LIBOR + 9.75% with 1.25% LIBOR floor), due 9/30/2018)(3)(4)	74,654	74,654	74,654	2.1%
				74,654	74,654	2.1%
American Gilsonite Company	Utah / Metal Services & Minerals	Second Lien Term Loan (11.50%, due 9/1/2017)(16)	38,500	38,500	38,500	1.1%
		Membership Interest (99.9999%)(15)		—	3,477	0.1%
				38,500	41,977	1.2%

Apidos CLO IX	Cayman Islands / Structured Finance	Subordinated Notes (Residual Interest, current yield 18.84%)(11)(22)	20,525	18,444	19,903	0.5%
				18,444	19,903	0.5%
Apidos CLO XI	Cayman Islands / Structured Finance	Subordinated Notes (Residual Interest, current yield 15.02%)(11)(22)	38,340	33,937	37,087	1.0%
				33,937	37,087	1.0%
Apidos CLO XII	Cayman Islands / Structured Finance	Subordinated Notes (Residual Interest, current yield 15.82%)(11)(22)	44,063	42,042	42,499	1.2%
				42,042	42,499	1.2%
Apidos CLO XV	Cayman Islands / Structured Finance	Subordinated Notes (Residual Interest, current yield 14.21%)(11)(22)	36,515	37,038	36,715	1.0%
				37,038	36,715	1.0%
Arctic Glacier U.S.A., Inc.	Minnesota / Food Products	Second Lien Term Loan (10.50% (LIBOR + 9.25% with 1.25% LIBOR floor), due 11/10/2019)(3)(4)	150,000	150,000	150,000	4.1%
				150,000	150,000	4.1%

See notes to consolidated financial statements.
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PROSPECT CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED SCHEDULES OF INVESTMENTS (CONTINUED)
(in thousands, except share data)

Portfolio Company	Locale / Industry	Investments(1)	June 30, 2014 Principal Value	Cost	Fair Value(2)	% of Net Assets
LEVEL 3 PORTFOLIO INVESTMENTS						
Non-Control/Non-Affiliate Investments (less than 5.00% voting control)						
Ark-La-Tex Wireline Services, LLC	Louisiana / Oil & Gas Services	Senior Secured Term Loan A (6.50% (LIBOR + 5.50% with 1.00% LIBOR floor), due 4/8/2019)(4)	$26,831	$26,831	$26,831	0.7%
		Senior Secured Term Loan B (10.50% (LIBOR + 9.50% with 1.00% LIBOR floor), due 4/8/2019)(4)	26,831	26,831	26,831	0.7%
		Delayed Draw Term Loan – $5,000 Commitment (expires 10/8/2015)(4)(25)	—	—	—	—%
				53,662	53,662	1.4%
Armor Holding II LLC	New York / Diversified Financial Services	Second Lien Term Loan (10.25% (LIBOR + 9.00% with 1.25% LIBOR floor), due 12/26/2020)(3)(4)(16)	7,000	6,874	6,874	0.2%
				6,874	6,874	0.2%
Atlantis Health Care Group (Puerto Rico), Inc.	Puerto Rico / Healthcare	Revolving Line of Credit – $3,000 Commitment (13.00% (LIBOR + 11.00% with 2.00% LIBOR floor), due 8/21/2014)(4)(25)(26)	2,350	2,350	2,350	0.1%
		Senior Term Loan (10.00% (LIBOR + 8.00% with 2.00% LIBOR floor), due 2/21/2018)(3)(4)	38,957	38,957	34,102	0.9%
				41,307	36,452	1.0%
Babson CLO Ltd. 2011-I	Cayman Islands / Structured Finance	Subordinated Notes (Residual Interest, current yield 12.44%)(11)(22)	35,000	33,591	33,801	0.9%
				33,591	33,801	0.9%
Babson CLO Ltd. 2012-I	Cayman Islands / Structured Finance	Subordinated Notes (Residual Interest, current yield 13.35%)(11)(22)	29,075	23,471	26,401	0.7%
				23,471	26,401	0.7%
Babson CLO Ltd. 2012-II	Cayman Islands / Structured Finance	Subordinated Notes (Residual Interest, current yield 11.33%)(11)(22)	27,850	26,764	27,230	0.8%
				26,764	27,230	0.8%
Blue Coat Systems, Inc.	Massachusetts / Software & Computer Services	Second Lien Term Loan (9.50% (LIBOR + 8.50% with 1.00% LIBOR floor), due 6/28/2020)(3)(4)(16)	11,000	10,902	11,000	0.3%
				10,902	11,000	0.3%

Broder Bros., Co.	Pennsylvania / Textiles, Apparel & Luxury Goods	Senior Secured Notes (10.25% (LIBOR + 9.00% with 1.25% LIBOR floor), due 4/8/2019)(3)(4)(46)	257,575	257,575	257,575	7.1%
				257,575	257,575	7.1%
Brookside Mill CLO Ltd.	Cayman Islands / Structured Finance	Subordinated Notes (Residual Interest, current yield 19.62%)(11)(22)	26,000	22,613	25,081	0.7%
				22,613	25,081	0.7%
Byrider Systems Acquisition Corp.	Indiana / Auto Finance	Senior Subordinated Notes (12.00% plus 2.00% PIK, due 11/3/2016)(3)(22)	11,139	11,139	11,139	0.3%
				11,139	11,139	0.3%
Caleel + Hayden, LLC	Colorado / Personal & Nondurable Consumer Products	Membership Interest(31)		—	182	—%
		Escrow Receivable		—	118	—%
				—	300	—%
Capstone Logistics, LLC	Georgia / Commercial Services	Senior Secured Term Loan A (6.50% (LIBOR + 5.00% with 1.50% LIBOR floor), due 9/16/2016)(4)	92,085	92,085	92,085	2.6%
		Senior Secured Term Loan B (11.50% (LIBOR + 10.00% with 1.50% LIBOR floor), due 9/16/2016)(3)(4)	98,465	98,465	98,465	2.7%
				190,550	190,550	5.3%
Cent CLO 17 Limited	Cayman Islands / Structured Finance	Subordinated Notes (Residual Interest, current yield 10.10%)(11)(22)	24,870	21,999	23,896	0.7%
				21,999	23,896	0.7%

See notes to consolidated financial statements.

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PROSPECT CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED SCHEDULES OF INVESTMENTS (CONTINUED)
(in thousands, except share data)

Portfolio Company	Locale / Industry	Investments(1)	June 30, 2014 Principal Value	Cost	Fair Value(2)	% of Net Assets
LEVEL 3 PORTFOLIO INVESTMENTS						
Non-Control/Non-Affiliate Investments (less than 5.00% voting control)						
Cent CLO 20 Limited	Cayman Islands / Structured Finance	Subordinated Notes (Residual Interest, current yield 10.83%)(11)(22)	$40,275	$40,483	$40,259	1.1%
				40,483	40,259	1.1%
Cent CLO 21 Limited	Cayman Islands / Structured Finance	Subordinated Notes (Residual Interest, current yield 15.47%)(11)(22)(48)	48,528	46,597	46,154	1.3%
				46,597	46,154	1.3%
CIFC Funding 2011-I, Ltd.	Cayman Islands / Structured Finance	Class D Senior Secured Notes (5.23% (LIBOR + 5.00%, due 1/19/2023)(4)(22)	19,000	15,304	18,037	0.5%
		Class E Subordinated Notes (7.23% (LIBOR + 7.00%, due 1/19/2023)(4)(22)	15,400	12,814	15,162	0.4%
				28,118	33,199	0.9%
CIFC Funding 2013-III, Ltd.	Cayman Islands / Structured Finance	Subordinated Notes (Residual Interest, current yield 14.01%)(11)(22)	44,100	39,534	43,217	1.2%
				39,534	43,217	1.2%
CIFC Funding 2013-IV, Ltd.	Cayman Islands / Structured Finance	Subordinated Notes (Residual Interest, current yield 12.52%)(11)(22)	45,500	40,255	40,934	1.1%
				40,255	40,934	1.1%
Cinedigm DC Holdings, LLC	New York / Software & Computer Services	Senior Secured Term Loan (11.00% (LIBOR + 9.00% with 2.00% LIBOR floor) plus 2.50% PIK, due 3/31/2021)(4)	68,714	68,664	68,714	1.9%
				68,664	68,714	1.9%
The Copernicus Group, Inc.	North Carolina / Healthcare	Escrow Receivable		—	115	—%
				—	115	—%
Correctional Healthcare Holding Company, Inc.	Colorado / Healthcare	Second Lien Term Loan (11.25%, due 1/11/2020)(3)	27,100	27,100	27,642	0.8%
				27,100	27,642	0.8%
Coverall North America, Inc.	Florida / Commercial Services	Senior Secured Term Loan (11.50% (LIBOR + 8.50% with 3.00% LIBOR floor), due 12/17/2017)(3)(4)	51,210	51,210	51,210	1.4%
				51,210	51,210	1.4%

Crosman Corporation	New York / Manufacturing	Second Lien Term Loan (12.00% (LIBOR + 10.50% with 1.50% LIBOR floor), due 12/30/2019)(3)(4)	40,000	40,000	39,708	1.1%
				40,000	39,708	1.1%
CRT MIDCO, LLC	Wisconsin / Media	Senior Secured Term Loan (10.50% (LIBOR + 7.50% with 3.00% LIBOR floor), due 6/30/2017)(3)(4)	47,504	47,504	47,504	1.3%
				47,504	47,504	1.3%
Deltek, Inc.	Virginia / Software & Computer Services	Second Lien Term Loan (10.00% (LIBOR + 8.75% with 1.25% LIBOR floor), due 10/10/2019)(3)(4)(16)	12,000	11,852	12,000	0.3%
				11,852	12,000	0.3%
Diamondback Operating, LP	Oklahoma / Oil & Gas Production	Net Profits Interest (15% of Equity Distributions)(7)		—	—	—%
				—	—	—%
Edmentum, Inc.(47)	Minnesota / Consumer Services	Second Lien Term Loan (11.25% (LIBOR + 9.75% with 1.50% LIBOR floor), due 5/17/2019)(3)(4)(16)	50,000	48,439	50,000	1.4%
				48,439	50,000	1.4%
Empire Today, LLC	Illinois / Durable Consumer Products	Senior Secured Note (11.375%, due 2/1/2017)(16)	15,700	15,419	15,700	0.4%
				15,419	15,700	0.4%
Fischbein, LLC	North Carolina / Machinery	Escrow Receivable		—	116	—%
				—	116	—%

See notes to consolidated financial statements.

PROSPECT CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED SCHEDULES OF INVESTMENTS (CONTINUED)
(in thousands, except share data)

Portfolio Company	Locale / Industry	Investments(1)	June 30, 2014 Principal Value	Cost	Fair Value(2)	% of Net Assets
LEVEL 3 PORTFOLIO INVESTMENTS						
Non-Control/Non-Affiliate Investments (less than 5.00% voting control)						
Fleetwash, Inc.	New Jersey / Business Services	Senior Secured Term Loan A (6.50% (LIBOR + 5.50% with 1.00% LIBOR floor), due 4/30/2019)(4)	$25,000	$25,000	$25,000	0.7%
		Senior Secured Term Loan B (10.50% (LIBOR + 9.50% with 1.00% LIBOR floor), due 4/30/2019)(4)	25,000	25,000	25,000	0.7%
		Delayed Draw Term Loan – $15,000 Commitment (expires 4/30/2019)(25)	—	—	—	—%
				50,000	50,000	1.4%
Focus Brands, Inc.	Georgia / Consumer Services	Second Lien Term Loan (10.25% (LIBOR + 9.00% with 1.25% LIBOR floor), due 8/21/2018)(4)(16)	18,000	17,776	18,000	0.5%
				17,776	18,000	0.5%
Focus Products Group International, LLC	Illinois / Durable Consumer Products	Senior Secured Term Loan (12.00% (LIBOR + 11.00% with 1.00% LIBOR floor), due 1/20/2017)(3)(4)	20,297	20,297	19,886	0.5%
		Common Stock (5,638 shares)		27	—	—%
				20,324	19,886	0.5%
Galaxy XII CLO, Ltd.	Cayman Islands / Structured Finance	Subordinated Notes (Residual Interest, current yield 13.31%)(11)(22)	22,000	19,498	20,449	0.6%
				19,498	20,449	0.6%
Galaxy XV CLO, Ltd.	Cayman Islands / Structured Finance	Subordinated Notes (Residual Interest, current yield 14.27%)(11)(22)	35,025	29,777	31,824	0.9%
				29,777	31,824	0.9%
Galaxy XVI CLO, Ltd.	Cayman Islands / Structured Finance	Subordinated Notes (Residual Interest, current yield 12.19%)(11)(22)	22,575	20,790	20,573	0.6%
				20,790	20,573	0.6%
Galaxy XVII CLO, Ltd.	Cayman Islands / Structured Finance	Subordinated Notes (Residual Interest, current yield 14.79%)(11)(22)(48)	39,905	36,811	36,589	1.0%
				36,811	36,589	1.0%
Global Employment Solutions, Inc.	Colorado / Business Services	Senior Secured Term Loan (10.00% (LIBOR + 9.00% with 1.00% LIBOR floor), due 3/25/2019)(3)(4)	28,464	28,464	28,464	0.8%

				28,464	28,464	0.8%
Grocery Outlet, Inc.	California / Retail	Second Lien Term Loan (10.50% (LIBOR + 9.25% with 1.25% LIBOR floor), due 6/17/2019)(4)(16)	14,457	14,168	14,457	0.4%
				14,168	14,457	0.4%
GTP Operations, LLC(10)	Texas / Software & Computer Services	Senior Secured Term Loan (10.00% (LIBOR + 5.00% with 5.00% LIBOR floor), due 12/11/2018)(3)(4)	112,546	112,546	112,546	3.1%
				112,546	112,546	3.1%
Halcyon Loan Advisors Funding 2012-1 Ltd.	Cayman Islands / Structured Finance	Subordinated Notes (Residual Interest, current yield 21.35%)(11)(22)	23,188	20,600	22,570	0.6%
				20,600	22,570	0.6%
Halcyon Loan Advisors Funding 2013-1 Ltd.	Cayman Islands / Structured Finance	Subordinated Notes (Residual Interest, current yield 18.49%)(11)(22)	40,400	38,460	41,509	1.1%
				38,460	41,509	1.1%
Halcyon Loan Advisors Funding 2014-1 Ltd.	Cayman Islands / Structured Finance	Subordinated Notes (Residual Interest, current yield 15.28%)(11)(22)	24,500	23,471	23,110	0.6%
				23,471	23,110	0.6%
Halcyon Loan Advisors Funding 2014-2 Ltd.	Cayman Islands / Structured Finance	Subordinated Notes (Residual Interest, current yield 16.06%)(11)(22)(48)	41,164	38,630	38,066	1.1%
				38,630	38,066	1.1%
Harley Marine Services, Inc.	Washington / Transportation	Second Lien Term Loan (10.50% (LIBOR + 9.25% with 1.25% LIBOR floor), due 12/20/2019)(3)(4)(16)	9,000	8,832	8,832	0.2%
				8,832	8,832	0.2%

See notes to consolidated financial statements.
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PROSPECT CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED SCHEDULES OF INVESTMENTS (CONTINUED)
(in thousands, except share data)

Portfolio Company	Locale / Industry	Investments(1)	June 30, 2014 Principal Value	Cost	Fair Value(2)	% of Net Assets
LEVEL 3 PORTFOLIO INVESTMENTS						
Non-Control/Non-Affiliate Investments (less than 5.00% voting control)						
ICON Health & Fitness, Inc.	Utah / Durable Consumer Products	Senior Secured Note (11.875%, due 10/15/2016)(16)	$21,850	$22,005	$20,889	0.6%
				22,005	20,889	0.6%
ICV-CSI Holdings, LLC	New York / Transportation	Common Equity (1.6 units)		1,639	2,079	0.1%
				1,639	2,079	0.1%
IDQ Holdings, Inc.	Texas / Automobile	Senior Secured Note (11.50%, due 4/1/2017)(16)	12,500	12,344	12,500	0.3%
				12,344	12,500	0.3%
Ikaria, Inc.	New Jersey / Healthcare	Second Lien Term Loan (8.75% (LIBOR + 7.75% with 1.00% LIBOR floor), due 2/12/2022)(4)(16)	25,000	24,430	25,000	0.7%
				24,430	25,000	0.7%
Injured Workers Pharmacy, LLC	Massachusetts / Healthcare	Second Lien Term Loan (11.50% (LIBOR + 7.00% with 4.50% LIBOR floor) plus 1.00% PIK, due 5/31/2019)(3)(4)	22,678	22,678	22,904	0.6%
				22,678	22,904	0.6%
Instant Web, LLC	Minnesota / Media	Senior Secured Term Loan A (5.50% (LIBOR + 4.50% with 1.00% LIBOR floor), due 3/28/2019)(4)	126,453	126,453	126,453	3.5%
		Senior Secured Term Loan B (12.00% (LIBOR + 11.00% with 1.00% LIBOR floor), due 3/28/2019)(3)(4)	128,000	128,000	128,000	3.6%
		Senior Secured Term Loan C (12.75% (LIBOR + 11.75% with 1.00% LIBOR floor), due 3/28/2019)(4)	12,500	12,500	12,500	0.3%
				266,953	266,953	7.4%
InterDent, Inc.	California / Healthcare	Senior Secured Term Loan A (7.25% (LIBOR + 5.75% with 1.50% LIBOR floor), due 8/3/2017)(4)	63,225	63,225	63,225	1.7%
		Senior Secured Term Loan B (12.25% (LIBOR + 9.25% with 3.00% LIBOR floor), due 8/3/2017)(3)(4)	67,625	67,625	67,625	1.9%
				130,850	130,850	3.6%
JHH Holdings, Inc.	Texas / Healthcare	Second Lien Term Loan (11.25% (LIBOR + 10.00% with 1.25% LIBOR	35,119	35,119	35,119	1.0%

		floor) plus 0.50% PIK, due 3/30/2019)(3)(4)				
				35,119	35,119	1.0%
LaserShip, Inc.	Virginia / Transportation	Revolving Line of Credit – $5,000 Commitment (10.25% (LIBOR + 8.25% with 2.00% LIBOR floor), due 12/21/2014)(4)(25)	—	—	—	—%
		Senior Secured Term Loan A (10.25% (LIBOR + 8.25% with 2.00% LIBOR floor), due 3/18/2019)(3)(4)	36,094	36,094	36,094	1.0%
		Senior Secured Term Loan B (10.25% (LIBOR + 8.25% with 2.00% LIBOR floor), due 3/18/2019)(3)(4)	22,111	22,111	22,111	0.6%
		Delayed Draw Term Loan – $6,000 Commitment (expires 12/31/2016)(25)	—	—	—	—%
				58,205	58,205	1.6%
LCM XIV Ltd.	Cayman Islands / Structured Finance	Income Notes (Residual Interest, current yield 16.02%)(11)(22)	26,500	24,914	25,124	0.7%
				24,914	25,124	0.7%
LHC Holdings Corp.	Florida / Healthcare	Revolving Line of Credit – $750 Commitment (8.50% (LIBOR + 6.00% with 2.50% LIBOR floor), due 5/31/2015)(4)(25)(26)	—	—	—	—%
		Senior Subordinated Debt (10.50%, due 5/31/2015)(3)	1,865	1,865	1,865	0.1%
		Membership Interest (125 units)		216	253	—%
				2,081	2,118	0.1%
Madison Park Funding IX, Ltd.	Cayman Islands / Structured Finance	Subordinated Notes (Residual Interest, current yield 12.97%)(11)(22)	31,110	24,546	27,266	0.8%
				24,546	27,266	0.8%

See notes to consolidated financial statements.

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PROSPECT CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED SCHEDULES OF INVESTMENTS (CONTINUED)
(in thousands, except share data)

Portfolio Company	Locale / Industry	Investments(1)	June 30, 2014 Principal Value	Cost	Fair Value(2)	% of Net Assets
LEVEL 3 PORTFOLIO INVESTMENTS						
Non-Control/Non-Affiliate Investments (less than 5.00% voting control)						
Matrixx Initiatives, Inc.	New Jersey / Pharmaceuticals	Senior Secured Term Loan A (7.50% (LIBOR + 6.00% with 1.50% LIBOR floor), due 8/9/2018)(3)(4)	$38,319	$38,319	$36,839	1.0%
		Senior Secured Term Loan B (12.50% (LIBOR + 11.00% with 1.50% LIBOR floor), due 8/9/2018)(3)(4)	39,750	39,750	36,851	1.0%
				78,069	73,690	2.0%
Maverick Healthcare Equity, LLC	Arizona / Healthcare	Preferred Units (1,250,000 units)		1,252	821	—%
		Class A Common Units (1,250,000 units)		—	—	—%
				1,252	821	—%
Mountain View CLO 2013-I Ltd.	Cayman Islands / Structured Finance	Subordinated Notes (Residual Interest, current yield 15.64%)(11)(22)	43,650	40,754	43,555	1.2%
				40,754	43,555	1.2%
NCP Finance Limited Partnership(23)	Ohio / Consumer Finance	Subordinated Secured Term Loan (11.00% (LIBOR + 9.75% with 1.25% LIBOR floor), due 9/30/2018)(3)(4)(16)(22)	11,910	11,692	12,208	0.3%
				11,692	12,208	0.3%
New Century Transportation, Inc.	New Jersey / Transportation	Senior Subordinated Term Loan (12.00% (LIBOR + 10.00% with 2.00% LIBOR floor) plus 4.00% PIK, in non-accrual status effective 4/1/2014, due 2/3/2018)(4)	44,000	44,000	—	—%
				44,000	—	—%
Nixon, Inc.	California / Durable Consumer Products	Senior Secured Term Loan (8.75% plus 2.75% PIK, due 4/16/2018)(16)	13,532	13,316	13,316	0.4%
				13,316	13,316	0.4%
NRG Manufacturing, Inc.	Texas / Manufacturing	Escrow Receivable		—	1,110	—%
				—	1,110	—%
Octagon Investment Partners XV, Ltd.	Cayman Islands / Structured Finance	Income Notes (Residual Interest, current yield 20.60%)(11)(22)	26,901	24,338	26,732	0.7%
				24,338	26,732	0.7%
Onyx Payments(44)	Texas / Diversified Financial Services	Senior Secured Term Loan A (6.75% (LIBOR + 5.50% with 1.25% LIBOR floor), due 4/18/2018)(4)	15,125	15,125	15,125	0.4%

		Senior Secured Term Loan B (13.75% (LIBOR + 12.50% with 1.25% LIBOR floor), due 4/18/2018)(4)	15,938	15,938	15,938	0.4%
				31,063	31,063	0.8%
Pelican Products, Inc.	California / Durable Consumer Products	Second Lien Term Loan (9.25% (LIBOR + 8.25% with 1.00% LIBOR floor), due 4/9/2021)(4)(16)	17,500	17,482	17,500	0.5%
				17,482	17,500	0.5%
PGX Holdings, Inc.(28)	Utah / Consumer Services	Senior Secured Term Loan (10.50% (LIBOR + 8.50% with 2.00% LIBOR floor), due 9/14/2017)(3)(4)	436,647	436,647	436,647	12.1%
				436,647	436,647	12.1%
Photonis Technologies SAS	France / Aerospace & Defense	First Lien Term Loan (8.50% (LIBOR + 7.50% with 1.00% LIBOR floor), due 9/18/2019)(4)(16)(22)	10,448	10,170	10,339	0.3%
				10,170	10,339	0.3%
Pinnacle (US) Acquisition Co. Limited	Texas / Software & Computer Services	Second Lien Term Loan (10.50% (LIBOR + 9.25% with 1.25% LIBOR floor), due 8/3/2020)(4)(16)	10,000	9,833	10,000	0.3%
				9,833	10,000	0.3%

See notes to consolidated financial statements.

PROSPECT CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED SCHEDULES OF INVESTMENTS (CONTINUED)
(in thousands, except share data)

Portfolio Company	Locale / Industry	Investments(1)	June 30, 2014 Principal Value	Cost	Fair Value(2)	% of Net Assets
LEVEL 3 PORTFOLIO INVESTMENTS						
Non-Control/Non-Affiliate Investments (less than 5.00% voting control)						
PrimeSport, Inc.	Georgia / Hotels, Restaurants & Leisure	Revolving Line of Credit – $15,000 Commitment (10.00% (LIBOR + 9.50% with 0.50% LIBOR floor), due 6/30/2015)(4)(25)(26)	$ —	$ —	$ —	—%
		Senior Secured Term Loan A (7.50% (LIBOR + 6.50% with 1.00% LIBOR floor), due 12/23/2019)(3)(4)	43,263	43,263	43,263	1.2%
		Senior Secured Term Loan B (11.50% (LIBOR + 10.50% with 1.00% LIBOR floor) plus 1.00% PIK, due 12/23/2019)(3)(4)	43,700	43,700	43,700	1.2%
				86,963	86,963	2.4%
Prince Mineral Holding Corp.	New York / Metal Services & Minerals	Senior Secured Term Loan (11.50%, due 12/15/2019)(16)	10,000	9,902	10,000	0.3%
				9,902	10,000	0.3%
Rocket Software, Inc.	Massachusetts / Software & Computer Services	Second Lien Term Loan (10.25% (LIBOR + 8.75% with 1.50% LIBOR floor), due 2/8/2019)(3)(4)(16)	20,000	19,758	20,000	0.6%
				19,758	20,000	0.6%
Royal Adhesives and Sealants, LLC	Indiana / Chemicals	Second Lien Term Loan (9.75% (LIBOR + 8.50% with 1.25% LIBOR floor), due 1/31/2019)(4)(16)	20,000	19,648	19,713	0.5%
				19,648	19,713	0.5%
Ryan, LLC	Texas / Business Services	Subordinated Unsecured Notes (12.00% (LIBOR + 9.00% with 3.00% LIBOR floor) plus 3.00% PIK, due 6/30/2018)(4)	70,531	70,531	70,531	1.9%
				70,531	70,531	1.9%
Sandow Media, LLC	Florida / Media	Senior Secured Term Loan (12.00%, due 5/8/2018)(3)	25,081	25,081	23,524	0.7%
				25,081	23,524	0.7%
Small Business Whole Loan Portfolio(19)	New York / Online Lending	144 small business loans purchased from On Deck Capital, Inc.	4,637	4,637	4,252	0.1%
				4,637	4,252	0.1%
Snacks Parent Corporation	Minnesota / Food Products	Series A Preferred Stock (4,021.45 shares)		—	—	—%
		Series B Preferred Stock (1,866.10 shares)		—	—	—%
		Warrant (to purchase 31,196.52 shares of Common Stock, expires 11/12/2020)		591	1,819	0.1%
				591	1,819	0.1%
			35,633	35,633	35,633	1.0%

Spartan Energy Services, Inc.	Louisiana / Oil & Gas Services	Senior Secured Term Loan (10.50% (LIBOR + 9.00% with 1.50% LIBOR floor), due 12/28/2017)(3)(4)				
				35,633	35,633	1.0%
Speedy Group Holdings Corp.	Canada / Consumer Finance	Senior Unsecured Notes (12.00%, due 11/15/2017)(16)(22)	15,000	15,000	15,000	0.4%
				15,000	15,000	0.4%
Sport Helmets Holdings, LLC	New York / Personal & Nondurable Consumer Products	Escrow Receivable		—	130	—%
				—	130	—%
Stauber Performance Ingredients, Inc.	California / Food Products	Senior Secured Term Loan (10.50% (LIBOR + 7.50% with 3.00% LIBOR floor), due 1/21/2016)(3)(4)	12,809	12,809	12,809	0.4%
		Senior Secured Term Loan (10.50% (LIBOR + 7.50% with 3.00% LIBOR floor), due 5/21/2017)(3)(4)	9,975	9,975	9,975	0.3%
				22,784	22,784	0.7%

See notes to consolidated financial statements.

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PROSPECT CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED SCHEDULES OF INVESTMENTS (CONTINUED)
(in thousands, except share data)

Portfolio Company	Locale / Industry	Investments(1)	June 30, 2014 Principal Value	Cost	Fair Value(2)	% of Net Assets
LEVEL 3 PORTFOLIO INVESTMENTS						
Non-Control/Non-Affiliate Investments (less than 5.00% voting control)						
Stryker Energy, LLC	Ohio / Oil & Gas Production	Subordinated Secured Revolving Credit Facility – $50,300 Commitment (12.25% (LIBOR + 10.75% with 1.50% LIBOR floor) plus 3.75% PIK, in non-accrual status effective 12/1/2011, due 12/1/2015)(4)(25)	$36,080	$32,710	$ —	—%
		Overriding Royalty Interests(18)		—	—	—%
				32,710	—	—%
Sudbury Mill CLO Ltd.	Cayman Islands / Structured Finance	Subordinated Notes (Residual Interest, current yield 16.25%)(11)(22)	28,200	26,914	26,140	0.7%
				26,914	26,140	0.7%
Symphony CLO IX Ltd.	Cayman Islands / Structured Finance	Preference Shares (Residual Interest, current yield 19.76%)(11)(22)	45,500	37,734	44,294	1.2%
				37,734	44,294	1.2%
Symphony CLO XIV Ltd.	Cayman Islands / Structured Finance	Subordinated Notes (Residual Interest, current yield 14.03%)(11)(22)(48)	49,250	49,858	49,025	1.4%
				49,858	49,025	1.4%
System One Holdings, LLC	Pennsylvania / Business Services	Senior Secured Term Loan (11.00% (LIBOR + 9.50% with 1.50% LIBOR floor), due 12/31/2018)(3)(4)	44,646	44,646	44,646	1.2%
				44,646	44,646	1.2%
Targus Group International, Inc.	California / Durable Consumer Products	First Lien Term Loan (11.00% (LIBOR + 9.50% with 1.50% LIBOR floor) plus 1.0% PIK, due 5/24/2016)(3)(4)(16)	21,911	21,697	19,949	0.6%
				21,697	19,949	0.6%
TB Corp.	Texas / Hotels, Restaurants & Leisure	Senior Subordinated Note (12.00% plus 1.50% PIK, due 12/19/2018)(3)	23,628	23,628	23,628	0.7%
				23,628	23,628	0.7%
Tectum Holdings, Inc.	Michigan / Automobile	Second Lien Term Loan (9.00% (LIBOR + 8.00% with 1.00% LIBOR floor), due 3/12/2019)(4)(16)	10,000	9,952	9,952	0.3%
				9,952	9,952	0.3%
Therakos, Inc.	New Jersey / Healthcare	Second Lien Term Loan (11.25% (LIBOR + 10.00% with 1.25% LIBOR floor), due 6/27/2018)(4)(16)	13,000	12,762	13,000	0.4%
				12,762	13,000	0.4%
Tolt Solutions, Inc.	South Carolina / Business Services	Senior Secured Term Loan A (7.00% (LIBOR + 6.00% with 1.00% LIBOR	48,705	48,705	48,705	1.3%

		floor), due 3/7/2019)(3)(4)				
		Senior Secured Term Loan B (12.00% (LIBOR + 11.00% with 1.00% LIBOR floor), due 3/7/2019)(3)(4)	48,900	48,900	48,900	1.4%
				97,605	97,605	2.7%
Traeger Pellet Grills LLC	Oregon / Durable Consumer Products	Senior Secured Term Loan A (6.50% (LIBOR + 4.50% with 2.00% LIBOR floor), due 6/18/2018)(3)(4)	29,100	29,100	29,100	0.8%
		Senior Secured Term Loan B (11.50% (LIBOR + 9.50% with 2.00% LIBOR floor), due 6/18/2018)(3)(4)	29,700	29,700	29,700	0.8%
				58,800	58,800	1.6%
Transaction Network Services, Inc.	Virginia / Telecommunication Services	Second Lien Term Loan (9.00% (LIBOR + 8.00% with 1.00% LIBOR floor), due 8/14/2020)(4)(16)	5,000	4,976	5,000	0.1%
				4,976	5,000	0.1%
TriMark USA, LLC	Massachusetts / Hotels, Restaurants & Leisure	Second Lien Term Loan (10.00% (LIBOR + 9.00% with 1.00% LIBOR floor), due 8/11/2019)(4)(16)	10,000	9,810	9,810	0.3%
				9,810	9,810	0.3%
United Sporting Companies, Inc.(5)	South Carolina / Durable Consumer Products	Second Lien Term Loan (12.75% (LIBOR + 11.00% with 1.75% LIBOR floor), due 5/16/2018)(3)(4)	160,000	160,000	160,000	4.4%
				160,000	160,000	4.4%

See notes to consolidated financial statements.
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PROSPECT CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED SCHEDULES OF INVESTMENTS (CONTINUED)
(in thousands, except share data)

Portfolio Company	Locale / Industry	Investments(1)	June 30, 2014 Principal Value	Cost	Fair Value(2)	% of Net Assets
LEVEL 3 PORTFOLIO INVESTMENTS						
Non-Control/Non-Affiliate Investments (less than 5.00% voting control)						
United States Environmental Services, LLC	Texas / Commercial Services	Senior Secured Term Loan A (6.50% (LIBOR + 5.50% with 1.00% LIBOR floor), due 3/31/2019)(3)(4)	$23,850	$23,850	$23,850	0.7%
		Senior Secured Term Loan B (11.50% (LIBOR + 10.50% with 1.00% LIBOR floor), due 3/31/2019)(3)(4)	36,000	36,000	36,000	1.0%
				59,850	59,850	1.7%
Venio LLC	Pennsylvania / Business Services	Second Lien Term Loan (12.00% (LIBOR + 9.50% with 2.50% LIBOR floor), due 2/19/2020)(3)(4)	17,000	17,000	16,726	0.5%
				17,000	16,726	0.5%
Voya CLO 2012-2, Ltd.	Cayman Islands / Structured Finance	Income Notes (Residual Interest, current yield 14.69%)(11)(22)	38,070	31,058	35,843	1.0%
				31,058	35,843	1.0%
Voya CLO 2012-3, Ltd.	Cayman Islands / Structured Finance	Income Notes (Residual Interest, current yield 12.97%)(11)(22)	46,632	39,368	43,960	1.2%
				39,368	43,960	1.2%
Voya CLO 2012-4, Ltd.	Cayman Islands / Structured Finance	Income Notes (Residual Interest, current yield 15.28%)(11)(22)	40,613	34,941	39,647	1.1%
				34,941	39,647	1.1%
Voya CLO 2014-1, Ltd.	Cayman Islands / Structured Finance	Subordinated Notes (Residual Interest, current yield 14.49%)(11)(22)(48)	32,383	33,825	32,949	0.9%
				33,825	32,949	0.9%
Washington Mill CLO Ltd.	Cayman Islands / Structured Finance	Subordinated Notes (Residual Interest, current yield 17.43%)(11)(22)(48)	22,600	21,601	21,583	0.6%
				21,601	21,583	0.6%
Water Pik, Inc.	Colorado / Personal & Nondurable Consumer Products	Second Lien Term Loan (9.75% (LIBOR + 8.75% with 1.00% LIBOR floor), due 1/8/2021)(4)(16)	11,000	10,604	10,604	0.3%
				10,604	10,604	0.3%

Wheel Pros, LLC	Colorado / Business Services	Senior Subordinated Secured Note (11.00% (LIBOR + 7.00% with 4.00% LIBOR floor), due 6/29/2020)(4)	12,000	12,000	12,000	0.3%
		Delayed Draw Term Loan – $3,000 Commitment (expires 12/30/2015)(25)	—	—	—	—%
				12,000	12,000	0.3%
Wind River Resources Corporation(39)	Utah / Oil & Gas Production	Senior Secured Note (13.00% (LIBOR + 7.50% with 5.50% LIBOR floor) plus 3.00% default interest on principal and 16.00% default interest on past due interest, in non-accrual status effective 12/1/2008, past due)(4)	15,000	14,650	—	—%
		Net Profits Interest (5% of Equity Distributions)(7)		—	—	—%
				14,650	—	—%
Total Non-Control/Non-Affiliate Investments (Level 3)				$4,620,388	$4,580,996	126.6%
Total Level 3 Portfolio Investments				$6,371,459	$6,253,571	172.8%

See notes to consolidated financial statements.

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PROSPECT CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED SCHEDULES OF INVESTMENTS (CONTINUED)
(in thousands, except share data)

June 30, 2014

Portfolio Company	Locale / Industry	Investments(1)	Principal Value	Cost	Fair Value(2)	% of Net Assets
LEVEL 1 PORTFOLIO INVESTMENTS						
Non-Control/Non-Affiliate Investments (less than 5.00% voting control)						
Dover Saddlery, Inc.	Massachusetts / Retail	Common Stock (30,974 shares)		$ 63	$ 168	—%
				63	168	—%
Total Non-Control/Non-Affiliate Investments (Level 1)				$ 63	$ 168	—%
Total Non-Control/Non-Affiliate Investments				$ 4,620,451	$ 4,581,164	126.6%
Total Portfolio Investments				$ 6,371,522	$ 6,253,739	172.8%

See notes to consolidated financial statements.
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PROSPECT CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED SCHEDULES OF INVESTMENTS – (CONTINUED)
(in thousands, except share data)

Endnote Explanations as of June 30, 2015 and June 30, 2014 (Continued)

(1) The terms "Prospect," "we," "us" and "our" mean Prospect Capital Corporation and its subsidiaries unless the context specifically requires otherwise. The securities in which Prospect has invested were acquired in transactions that were exempt from registration under the Securities Act of 1933, as amended (the "Securities Act"). These securities may be resold only in transactions that are exempt from registration under the Securities Act.

(2) Fair value is determined by or under the direction of our Board of Directors. As of June 30, 2015 and June 30, 2014, one of our portfolio investments, Dover Saddlery, Inc., was publicly traded and classified as Level 1 within the valuation hierarchy established by ASC 820, Fair Value Measurement ("ASC 820"). As of June 30, 2015 and June 30, 2014, the fair value of our remaining portfolio investments was determined using significant unobservable inputs. ASC 820 classifies such inputs used to measure fair value as Level 3 within the valuation hierarchy. See Notes 2 and 3 within the accompanying notes to consolidated financial statements for further discussion.

(3) Security, or a portion thereof, is held by Prospect Capital Funding LLC ("PCF"), our wholly-owned subsidiary and a bankruptcy remote special purpose entity, and is pledged as collateral for the Revolving Credit Facility and such security is not available as collateral to our general creditors (see Note 4). The fair values of these investments held by PCF at June 30, 2015 and June 30, 2014 were $1,511,585 and $1,500,897, respectively; they represent 22.9% and 24.0% of our total investments, respectively.

(4) Security, or a portion thereof, has a floating interest rate which may be subject to a LIBOR or PRIME floor. Stated interest rate was in effect at June 30, 2015 and June 30, 2014.

(5) Ellett Brothers, LLC, Evans Sports, Inc., Jerry's Sports, Inc., Simmons Gun Specialties, Inc., Bonitz Brothers, Inc., and Outdoor Sports Headquarters, Inc. are joint borrowers on the second lien term loan. United Sporting Companies, Inc. is a parent guarantor of this debt investment.

(6) On January 19, 2010, we modified the terms of our senior secured debt in Appalachian Energy Holdings, LLC ("AEH") and Coalbed, LLC ("Coalbed") in conjunction with the formation of Manx Energy, Inc. ("Manx"), a new entity consisting of the assets of AEH, Coalbed and Kinley Exploration. The assets of the three companies were brought under new common management. We funded $2,800 at closing to Manx to provide for working capital. As part of the Manx roll-up, our loans to AEH and Coalbed were assigned to Manx and a portion of the debt was exchanged for Manx preferred equity, while our AEH equity interest was converted into Manx common stock. There was no change to fair value at the time of restructuring. On June 30, 2012, Manx returned the investments in Coalbed and AEH to us and we contributed these investments to Wolf Energy Holdings Inc. ("Wolf Energy Holdings"), a newly-formed, separately owned holding company. During the three months ended June 30, 2013, we determined that the impairment of Manx was other-than-temporary and recorded a realized loss of $9,397 for the amount that the amortized cost exceeded the fair value, reducing the amortized cost to $500. As of June 30, 2014, Prospect owned 41% of the equity of Manx. During the three months ended December 31, 2014, Manx was dissolved and we recorded a realized loss of $50, reducing the amortized cost to zero.

(7) In addition to the stated returns, the net profits interest held will be realized upon sale of the borrower or a sale of the interests.

(8) During the quarter ended December 31, 2011, our ownership of Change Clean Energy Holdings, LLC, Change Clean Energy, LLC, Freedom Marine Services Holdings, LLC ("Freedom Marine"), and Yatesville Coal Holdings, LLC was transferred to Energy Solutions Holdings Inc. (f/k/a Gas Solutions Holdings, Inc.) ("Energy Solutions") to consolidate all of our energy holdings under one management team. We own 100% of Energy Solutions. On December 28, 2011, we made a $3,500 debt investment in Vessel Holdings, LLC, a subsidiary of Freedom Marine. On November 25, 2013, we provided $13,000 in senior secured debt financing for the recapitalization of our investment in Jettco Marine Services, LLC ("Jettco"), a subsidiary of Freedom Marine. The subordinated secured loan to Jettco was replaced with a senior secured note to Vessel Holdings II, LLC, a new subsidiary of Freedom Marine. On December 3, 2013, we made a $16,000 senior secured investment in Vessel

Holdings III, LLC, another new subsidiary of Freedom Marine. On June 4, 2014, Gas Solutions GP LLC and Gas Solutions LP LLC, two subsidiaries of Energy Solutions, merged with and into Freedom Marine, with Freedom Marine as the surviving entity. In June 2014, Freedom Marine Services Holdings, LLC was renamed Freedom Marine Solutions, LLC; Vessel Holdings, LLC was renamed Vessel Company, LLC; Vessel Holdings II, LLC was renamed Vessel Company II, LLC; Vessel Holdings III, LLC was renamed Vessel Company III, LLC; Yatesville Coal Holdings, LLC was renamed Yatesville Coal Company, LLC; and Change Clean Energy Holdings, LLC was renamed Change Clean Energy Company, LLC. On July 1, 2014, we began consolidating Energy Solutions and as a result, we began reporting our investments in Change Clean Energy Company, LLC, Freedom Marine Solutions, LLC and Yatesville Coal Company, LLC as separate controlled companies. During the three months ended December 31, 2014, we determined that the impairments of Change Clean Energy Company, LLC and Yatesville Coal Company, LLC were other-than-temporary and recorded a realized loss of $1,449, reducing the amortized cost to zero.

See notes to consolidated financial statements.
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PROSPECT CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED SCHEDULES OF INVESTMENTS – (CONTINUED)
(in thousands, except share data)

Endnote Explanations as of June 30, 2015 and June 30, 2014 (Continued)

(9) As of June 30, 2014, we owned 100% of the equity of Vets Securing America, Inc. (“VSA”) and 100% of the equity of The Healing Staff, Inc. (“THS”), a former wholly-owned subsidiary of ESA Environmental Specialists, Inc. As of June 30, 2014, THS and VSA were joint borrowers on the secured promissory notes. On June 5, 2015, we sold our equity investment in VSA and realized a net loss of $975 on the sale. In connection with the sale, VSA was released as a borrower on the secured promissory notes, leaving THS as the sole borrower. During the year ended June 30, 2015, THS ceased operations and we recorded a realized loss of $2,956, reducing the amortized cost to zero.

(10) GTP Operations, LLC, Transplace, LLC, CI (Transplace) International, LLC, Transplace Freight Services, LLC, Transplace Texas, LP, Transplace Stuttgart, LP, Transplace International, Inc., Celtic International, LLC, and Treetop Merger Sub, LLC are joint borrowers on the senior secured term loan.

(11) The CLO equity investments are entitled to recurring distributions which are generally equal to the excess cash flow generated from the underlying investments after payment of the contractual payments to debt holders and fund expenses. The current estimated yield is based on the current projections of this excess cash flow taking into account assumptions which have been made regarding expected prepayments, losses and future reinvestment rates. These assumptions are periodically reviewed and adjusted. Ultimately, the actual yield may be higher or lower than the estimated yield if actual results differ from those used for the assumptions.

(12) Wolf Energy Holdings, an entity in which we own 100% of the common stock, owns 100% of the equity of Wolf Energy, LLC (“Wolf Energy”). Effective June 30, 2012, the membership interests and associated operating company debt of AEH and Coalbed, which were previously owned by Manx, were assigned to Wolf Energy Holdings. Effective June 6, 2014, Appalachian Energy Holdings, LLC was renamed Appalachian Energy LLC. On July 1, 2014, we began consolidating Wolf Energy Holdings and as a result, we began reporting our investments in Appalachian Energy LLC, Coalbed, LLC and Wolf Energy, LLC as separate controlled companies. During the three months ended September 30, 2014, we determined that the impairment of Appalachian Energy LLC was other-than-temporary and recorded a realized loss of $2,050, reducing the amortized cost to zero. On November 21, 2014, Coalbed merged with and into Wolf Energy, with Wolf Energy as the surviving entity. During the three months ended December 31, 2014, we determined that the impairment of the Coalbed debt assumed by Wolf Energy was other-than-temporary and recorded a realized loss of $5,991, reducing the amortized cost to zero.

(13) On a fully diluted basis represents 10.00% of voting common shares.

(14) Trinity Services Group, Inc. and Trinity Services I, LLC are joint borrowers on the senior secured loan facility.

(15) We own 99.9999% of AGC/PEP, LLC. AGC/PEP, LLC owns 2,037.65 out of a total of 83,818.69 shares (including 5,111 vested and unvested management options) of American Gilsonite Holding Company which owns 100% of American Gilsonite Company.

(16) Syndicated investment which was originated by a financial institution and broadly distributed.

(17) MITY Holdings of Delaware Inc. (“MITY Delaware”), an entity in which we own 100% of the common stock, owns 94.99% of the equity of MITY, Inc. (f/k/a MITY Enterprises, Inc.) (“MITY”). MITY owns 100% of each of MITY-Lite, Inc.; Broda Enterprises USA, Inc.; and Broda Enterprises ULC (“Broda Canada”). On June 23, 2014, Prospect made a new $15,769 debt investment in MITY and MITY distributed proceeds to MITY Delaware as a return of capital. MITY Delaware used this distribution to pay down the senior secured debt of MITY Delaware to Prospect by the same amount. The remaining amount of the senior secured debt due from MITY Delaware to Prospect, $7,200, was then contributed to the capital of MITY Delaware. As a result of this transaction, Prospect held the $15,769 MITY note. Effective June 23, 2014, Mity Enterprises, Inc. was renamed MITY, Inc. and Broda Enterprises USA, Inc. was renamed Broda USA, Inc. On June 23, 2014, Prospect also extended a new $7,500 senior secured revolving facility to MITY, of which none was funded at closing. On July 1, 2014, we began

consolidating MITY Delaware and as a result, we now report MITY, Inc. as a separate controlled company. MITY Delaware has a subordinated unsecured note issued and outstanding to Broda Canada that is denominated in Canadian Dollars (CAD). As of June 30, 2015, the principal balance of this note was CAD 7,371. In accordance with ASC 830, Foreign Currency Matters ("ASC 830"), this note was remeasured into our functional currency, US Dollars (USD), and is presented on our Consolidated Schedule of Investments in USD.

(18) The overriding royalty interests held receive payments at the stated rates based upon operations of the borrower.

(19) Our wholly-owned subsidiary Prospect Small Business Lending, LLC purchases small business whole loans on a recurring basis from online small business loan originators, including On Deck Capital, Inc. and Direct Capital Corporation.

See notes to consolidated financial statements.

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PROSPECT CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED SCHEDULES OF INVESTMENTS – (CONTINUED)
(in thousands, except share data)

Endnote Explanations as of June 30, 2015 and June 30, 2014 (Continued)

(20) Boxercraft Incorporated ("Boxercraft") and BXC Company, Inc. (f/k/a BXC Holding Company) ("BXC") are joint borrowers on our senior secured investments. Effective March 28, 2014, we acquired voting control of BXC pursuant to a voting agreement and irrevocable proxy. Effective May 8, 2014, we acquired control of BXC by transferring shares held by the other equity holders of BXC to us pursuant to an assignment agreement entered into with such other equity holders. As of June 30, 2014, we owned 86.7% of Series A preferred stock, 96.8% of Series B preferred stock, and 83.1% of the fully-diluted common stock of BXC. BXC owned 100% of the common stock of Boxercraft. We owned a warrant to purchase 15% of all classes of equity of BXC, which consisted of 3,755,000 shares of Series A preferred stock, 625,000 shares of Series B preferred stock, and 43,800 shares of voting common stock as of June 30, 2014. On August 25, 2014, we sold Boxercraft, a wholly-owned subsidiary of BXC, for net proceeds of $750 and realized a net loss of $16,949 on the sale.

(21) We owned warrants to purchase 33,750 shares of common stock in Metal Buildings Holding Corporation ("Metal Buildings"), the former holding company of Borga, Inc. ("Borga"). Metal Buildings owned 100% of Borga. On March 8, 2010, we foreclosed on the stock in Borga that was held by Metal Buildings, obtaining 100% ownership of Borga. On January 24, 2014, we contributed our holdings in Borga to STI Holding, Inc. ("STI"), a wholly-owned holding company. On July 1, 2014, we began consolidating STI and as a result, we reported Borga, Inc. as a separate controlled company from July 1, 2014 until its sale on August 20, 2014. On August 20, 2014, we sold the assets of Borga, a wholly-owned subsidiary of STI, for net proceeds of $382 and realized a loss of $2,589 on the sale. On December 29, 2014, Borga was dissolved.

(22) Investment has been designated as an investment not "qualifying" under Section 55(a) of the Investment Company Act of 1940 (the "1940 Act"). Under the 1940 Act, we may not acquire any non-qualifying asset unless, at the time such acquisition is made, qualifying assets represent at least 70% of our total assets. We monitor the status of these assets on an ongoing basis.

(23) NCP Finance Limited Partnership, NCP Finance Ohio, LLC, and certain affiliates thereof are joint borrowers on the subordinated secured term loan.

(24) On May 6, 2011, we made a secured first lien $24,250 debt investment to NMMB, Inc. (f/k/a NMMB Acquisition, Inc.) ("NMMB"), a $2,800 secured debt and $4,400 equity investment to NMMB Holdings, Inc. ("NMMB Holdings"). We owned 100% of the Series A Preferred Stock in NMMB Holdings. NMMB Holdings owned 100% of the Convertible Preferred Stock in NMMB. On December 13, 2013, we provided $8,086 in preferred equity for the recapitalization of NMMB Holdings. After the restructuring, we received repayment of $2,800 secured debt outstanding. We own 100% of the equity of NMMB Holdings as of June 30, 2015 and June 30, 2014. NMMB Holdings owns 96.33% and 92.93% of the fully diluted equity of NMMB as of June 30, 2015 and June 30, 2014, respectively. NMMB owns 100% of Refuel Agency, Inc. ("Refuel Agency"), which owns 100% of Armed Forces Communications, Inc. ("Armed Forces"). On June 12, 2014, Prospect made a new $7,000 senior secured term loan to Armed Forces. Armed Forces distributed this amount to Refuel Agency as a return of capital. Refuel Agency distributed this amount to NMMB as a return of capital, which was used to pay down $7,000 of NMMB's $10,714 senior secured term loan to Prospect. On July 1, 2014, we began consolidating NMMB Holdings and as a result, we now report NMMB, Inc. as a separate controlled company.

(25) Undrawn committed revolvers and delayed draw term loans to our portfolio companies incur commitment and unused fees ranging from 0.00% to 2.00%. As of June 30, 2015 and June 30, 2014, we had $88,288 and $72,118, respectively, of undrawn revolver and delayed draw term loan commitments to our portfolio companies.

(26) Stated interest rates are based on June 30, 2015 and June 30, 2014 one month or three month LIBOR rates plus applicable spreads based on the respective credit agreements. Interest rates are subject to change based on actual elections by the borrower for a LIBOR rate contract or Base Rate contract when drawing on the revolver.

(27)

On July 30, 2010, we made a $30,000 senior secured debt investment in Airmall Inc. (“Airmall”), a $12,500 secured second lien in AMU Holdings Inc. (“AMU”), and acquired 100% of the Series A preferred stock and common stock of AMU. Our preferred stock in AMU had a 12.0% dividend rate which was paid from the dividends received from its operating subsidiary, Airmall. AMU owned 100% of the common stock in Airmall. On December 4, 2013, we sold a $972 participation in both debt investments, equal to 2% of the outstanding principal amount of loans on that date. On June 13, 2014, Prospect made a new $19,993 investment as a senior secured loan to Airmall. Airmall then distributed this amount to AMU as a return of capital, which AMU used to pay down the senior subordinated loan in the same amount. The minority interest held by a third party in AMU was exchanged for common stock of Airmall. As of June 30, 2014, we owned 100% of the equity of AMU, which owned 98% of Airmall. On July 1, 2014, we began consolidating AMU and as a result, we reported Airmall Inc. as a separate controlled company from July 1, 2014 until its sale on August 1, 2014. On August 1, 2014, we sold our investments in Airmall for net proceeds of $51,379 and realized a loss of $3,473 on the sale. In addition, there is $6,000 being held in escrow, of which 98% is due to Prospect, which will be recognized as an additional realized loss if it is not received. On October 22, 2014, we received a tax refund of $665 related to our investment in Airmall for which we realized a gain of the same amount.

See notes to consolidated financial statements.

PROSPECT CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED SCHEDULES OF INVESTMENTS – (CONTINUED)
(in thousands, except share data)

Endnote Explanations as of June 30, 2015 and June 30, 2014 (Continued)

(28) As of June 30, 2014, Progrexion Marketing, Inc., Progrexion Teleservices, Inc., Progrexion ASG, Inc., Progrexion IP, Inc., Creditrepair.com, Inc., and eFolks, LLC were joint borrowers on the senior secured term loan. PGX Holdings, Inc. was the parent guarantor of this debt investment. As of June 30, 2015, PGX Holdings, Inc. is the sole borrower on the second lien term loan.

(29) First Tower Holdings of Delaware LLC (“First Tower Delaware”), an entity in which we own 100% of the membership interests, owns 80.1% of First Tower Finance Company LLC (“First Tower Finance”), which owns 100% of First Tower, LLC (“First Tower”), the operating company. On June 24, 2014, Prospect made a new $251,246 second lien term loan to First Tower. First Tower distributed this amount to First Tower Finance, which distributed this amount to First Tower Delaware as a return of capital. First Tower Delaware used the distribution to partially pay down the Senior Secured Revolving Credit Facility. The remaining $23,712 of the Senior Secured Revolving Credit Facility was then converted to additional membership interests held by Prospect in First Tower Delaware. On July 1, 2014, we began consolidating First Tower Delaware and as a result, we now report First Tower Finance Company LLC as a separate controlled company.

(30) Arctic Oilfield Equipment USA, Inc. (“Arctic Equipment”), an entity in which we own 100% of the common equity, owns 70% of the equity of Arctic Energy Services, LLC (“Arctic Energy”), the operating company. On July 1, 2014, we began consolidating Arctic Equipment and as a result, we now report Arctic Energy as a separate controlled company.

(31) We own 2.8% (13,220 shares) of Mineral Fusion Natural, LLC, a subsidiary of Caleel + Hayden, LLC, common and preferred interest.

(32) APH Property Holdings, LLC (“APH”), an entity in which we own 100% of the membership interests, owns 100% of the common equity of American Property REIT Corp. (f/k/a American Property Holdings Corp.) (“APRC”), a qualified REIT which holds investments in several real estate properties. Effective April 1, 2014, Prospect made a new $167,162 senior term loan to APRC. APRC then distributed this amount to APH as a return of capital which was used to pay down the Senior Term Loan from APH by the same amount. On July 1, 2014, we began consolidating APH and as a result, we now report APRC as a separate controlled company. See Note 3 for further discussion of the properties held by APRC.

(33) CCPI Holdings Inc. (“CCPI Holdings”), an entity in which we own 100% of the common stock, owns 94.95% and 94.77% of CCPI Inc. (“CCPI”), the operating company, as of June 30, 2015 and June 30, 2014, respectively. On June 13, 2014, Prospect made a new $8,218 senior secured note to CCPI. CCPI then distributed this amount to CCPI Holdings as a return of capital which was used to pay down the $8,216 senior secured note from CCPI Holdings to Prospect. The remaining $2 was distributed to Prospect as a return of capital of Prospect’s equity investment in CCPI Holdings. On July 1, 2014, we began consolidating CCPI Holdings and as a result, we now report CCPI Inc. as a separate controlled company.

(34) Credit Central Holdings of Delaware, LLC (“Credit Central Delaware”), an entity in which we own 100% of the membership interests, owns 74.93% and 74.75% of Credit Central Loan Company, LLC (f/k/a Credit Central Holdings, LLC) (“Credit Central”) as of June 30, 2015 and June 30, 2014, respectively. Credit Central owns 100% of each of Credit Central, LLC; Credit Central South, LLC; Credit Central of Texas, LLC; and Credit Central of Tennessee, LLC, the operating companies. On June 26, 2014, Prospect made a new $36,333 second lien term loan to Credit Central. Credit Central then distributed this amount to Credit Central Delaware as a return of capital which was used to pay down the Senior Secured Revolving Credit Facility from Credit Central Delaware by the same amount. The remaining amount of the Senior Secured Revolving Credit Facility, $3,874, was then converted into additional membership interests in Credit Central Delaware. On July 1, 2014, we began consolidating Credit Central Delaware and as a result, we now report Credit Central Loan Company, LLC as a separate controlled company.

(35) Valley Electric Holdings I, Inc. (“Valley Holdings I”), an entity in which we own 100% of the common stock, owns 100% of Valley Electric Holdings II, Inc. (“Valley Holdings II”). Valley Holdings II owns 94.99% of Valley Electric Company, Inc. (“Valley Electric”). Valley Electric owns 100% of the equity of VE Company, Inc., which owns 100% of the equity of Valley Electric Co. of Mt. Vernon, Inc. (“Valley”). On June 24, 2014, Valley Holdings II and management of Valley formed Valley Electric and contributed their shares of Valley stock to Valley Electric. Prospect made a new $20,471 senior secured loan to Valley Electric. Valley Electric then distributed this amount to Valley Holdings I, via Valley Holdings II, as a return of capital which was used to pay down the senior secured note of Valley Holdings I by the same amount. The remaining principal amount of the senior secured note, $16,754, was then contributed to the capital of Valley Holdings I. On July 1, 2014, we began consolidating Valley Holdings I and Valley Holdings II and as a result, we now report Valley Electric Company, Inc. as a separate controlled company.

See notes to consolidated financial statements.

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PROSPECT CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED SCHEDULES OF INVESTMENTS – (CONTINUED)
(in thousands, except share data)

Endnote Explanations as of June 30, 2015 and June 30, 2014 (Continued)

(36) Nationwide Acceptance Holdings LLC (“Nationwide Holdings”), an entity in which we own 100% of the membership interests, owns 93.79% of Nationwide Loan Company LLC (f/k/a Nationwide Acceptance LLC) (“Nationwide”), the operating company. On June 18, 2014, Prospect made a new $14,820 second lien term loan to Nationwide. Nationwide distributed this amount to Nationwide Holdings as a return of capital. Nationwide Holdings used the distribution to pay down the Senior Secured Revolving Credit Facility. The remaining $9,888 of the Senior Secured Revolving Credit Facility was then converted into additional membership interests in Nationwide Holdings. On July 1, 2014, we began consolidating Nationwide Holdings and as a result, we now report Nationwide Loan Company LLC as a separate controlled company. On June 1, 2015, Nationwide completed a corporate reorganization. As part of the reorganization, Nationwide Acceptance LLC was renamed Nationwide Loan Company LLC (continues as “Nationwide”) and formed two new wholly-owned subsidiaries: Pelican Loan Company LLC (“Pelican”) and Nationwide Consumer Loans LLC. Nationwide assigned 100% of the equity interests in its other subsidiaries to Pelican which, in turn, assigned these interests to Nationwide Acceptance LLC (“New Nationwide”), the new operating company wholly-owned by Pelican. New Nationwide also assumed the existing senior subordinated term loan due to Prospect.

(37) On April 15, 2013, assets previously held by H&M Oil & Gas, LLC (“H&M”) were assigned to Wolf Energy in exchange for a $66,000 term loan secured by the assets. The cost basis in this loan of $44,632 was determined in accordance with ASC 310-40, Troubled Debt Restructurings by Creditors, and was equal to the fair value of assets at the time of transfer resulting in a capital loss of $19,647 in connection with the foreclosure on the assets. On May 17, 2013, Wolf Energy sold the assets located in Martin County, which were previously held by H&M, for $66,000. Proceeds from the sale were primarily used to repay the loan, accrued interest and net profits interest receivable due to us resulting in a realized capital gain of $11,826. We received $3,960 of structuring and advisory fees from Wolf Energy during the year ended June 30, 2013 related to the sale and $991 under the net profits interest agreement which was recognized as other income during the fiscal year ended June 30, 2013.

(38) CP Holdings of Delaware LLC (“CP Holdings”), an entity in which we own 100% of the membership interests, owns 82.3% and 82.9% of CP Energy Services Inc. (“CP Energy”) as of June 30, 2015 and June 30, 2014, respectively. As of June 30, 2014, CP Energy owned directly or indirectly 100% of each of CP Well Testing Services, LLC (“CP Well Testing”); CP Well Testing, LLC (“CP Well”); Fluid Management Services, Inc.; Fluid Management Services, LLC; Wright Transport, Inc.; Wright Foster Disposals, LLC; Foster Testing Co., Inc.; ProHaul Transports, LLC; Artexoma Logistics, LLC; and Wright Trucking, Inc. On April 1, 2014, Prospect made new loans to CP Well (with ProHaul Transports, LLC; Wright Trucking, Inc.; and Foster Testing Co., Inc. as co-borrowers), comprised of two first lien loans in the amount of $11,035 and $72,238 and a second lien loan in the amount of $15,000. The proceeds of these loans were used to repay CP Well Testing’s senior secured term loan and CP Energy’s senior secured term loan from Prospect. On July 1, 2014, we began consolidating CP Holdings and as a result, we now report CP Energy Services Inc. as a separate controlled company. Effective December 31, 2014, CP Energy underwent a corporate reorganization in order to consolidate certain of its wholly-owned subsidiaries. As of June 30, 2015, CP Energy owned directly or indirectly 100% of each of CP Well; Wright Foster Disposals, LLC; Foster Testing Co., Inc.; ProHaul Transports, LLC; and Wright Trucking, Inc.

(39) Wind River Resources Corporation and Wind River II Corporation are joint borrowers on the senior secured note.

(40) NPH Property Holdings, LLC (“NPH”), an entity in which we own 100% of the membership interests, owns 100% of the common equity of National Property REIT Corp. (f/k/a National Property Holdings Corp.) (“NPRC”), a property REIT which holds investments in several real estate properties. Additionally, through its wholly-owned subsidiaries, NPRC invests in online consumer loans. Effective April 1, 2014, Prospect made a new $104,460 senior term loan to NPRC. NPRC then distributed this amount to NPH as a return of capital which was used to

pay down the Senior Term Loan from NPH by the same amount. On July 1, 2014, we began consolidating NPH and as a result, we now report NPRC as a separate controlled company. See Note 3 for further discussion of the properties held by NPRC. On March 17, 2015, we entered into a new credit agreement with ACL Loan Holdings, Inc. ("ACLLH"), a wholly-owned subsidiary of NPRC, to form two new tranches of senior secured term loans, Term Loan A and Term Loan B, with the same terms as the existing NPRC Term Loan A and Term Loan B due to us. The agreement was effective as of June 30, 2014. On June 30, 2014, ACLLH made a non-cash return of capital distribution of $22,390 to NPRC and NPRC transferred and assigned to ACLLH a senior secured Term Loan A due to us. On June 2, 2015, we amended the credit agreement with NPRC to form two new tranches of senior secured term loans, Term Loan C and Term Loan D, with the same terms as the existing ACLLH Term Loan A and Term Loan B due to us. The amendment was effective as of April 1, 2015.

(41) UPH Property Holdings, LLC ("UPH"), an entity in which we own 100% of the membership interests, owns 100% of the common equity of United Property REIT Corp. (f/k/a United Property Holdings Corp.) ("UPRC"), a property REIT which holds investments in several real estate properties. Effective April 1, 2014, Prospect made a new $19,027 senior term loan to UPRC. UPRC then distributed this amount to UPH as a return of capital which was used to pay down the Senior Term Loan from UPH by the same amount. On July 1, 2014, we began consolidating UPH and as a result, we now report UPRC as a separate controlled company. See Note 3 for further discussion of the properties held by UPRC.

See notes to consolidated financial statements.

PROSPECT CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED SCHEDULES OF INVESTMENTS – (CONTINUED)
(in thousands, except share data)

Endnote Explanations as of June 30, 2015 and June 30, 2014 (Continued)

(42) On April 4, 2008, we acquired a controlling equity interest in ARRM Holdings, Inc. (“ARRM”), which owned 100% of Ajax Rolled Ring & Machine, LLC (“Ajax”), the operating company. On April 1, 2013, we refinanced the existing $19,837 and $18,635 senior loans to Ajax and ARRM, respectively, increasing the total size of the debt investment to $38,537. Concurrent with the refinancing, we received repayment of the $18,635 loans previously outstanding. On October 11, 2013, we provided $25,000 in preferred equity for the recapitalization of ARRM. After the financing, we received repayment of the $20,009 subordinated unsecured loan previously outstanding. On June 12, 2014, ARRM Holdings, Inc. was renamed ARRM Services, Inc. As of June 30, 2014, we controlled 79.53% of the fully-diluted common, 85.76% of the Series A Preferred and 100% of the Series B Preferred equity of ARRM. On October 10, 2014, ARRM sold Ajax to a third party and repaid the $19,337 loan receivable to us and we recorded a realized loss of $23,560 related to the sale. Concurrent with the sale, our ownership increased to 100% of the outstanding equity of ARRM Services, Inc. which was renamed SB Forging Company, Inc. (“SB Forging”). As such, we began consolidating SB Forging on October 11, 2014. In addition, there is $3,000 being held in escrow of which $802 was received on May 6, 2015 for which we realized a gain of the same amount. The remainder will be recognized as additional gain if and when received.

(43) Harbortouch Holdings of Delaware Inc. (“Harbortouch Delaware”), an entity in which we own 100% of the common stock, owns 100% of the Class C voting units of Harbortouch Payments, LLC (“Harbortouch”), which provide for a 53.5% residual profits allocation. Harbortouch management owns 100% of the Class B and Class D voting units of Harbortouch, which provide for a 46.5% residual profits allocation. Harbortouch owns 100% of Credit Card Processing USA, LLC. On April 1, 2014, Prospect made a new $137,226 senior secured term loan to Harbortouch. Harbortouch then distributed this amount to Harbortouch Delaware as a return of capital which was used to pay down the $123,000 senior secured note from Harbortouch Delaware to Prospect. The remaining $14,226 was distributed to Prospect as a return of capital of Prospect’s equity investment in Harbortouch Delaware. On July 1, 2014, we began consolidating Harbortouch Delaware and as a result, we now report Harbortouch Payments, LLC as a separate controlled company.

(44) Pegasus Business Intelligence, LP, Paycom Acquisition, LLC, and Paycom Acquisition Corp. are joint borrowers on the senior secured loan facility. Paycom Intermediate Holdings, Inc. is the parent guarantor of this debt investment. These entities transact business internationally under the trade name Onyx Payments.

(45) Security Alarm Financing Enterprises, L.P. and California Security Alarms, Inc. are joint borrowers on the senior subordinated note.

(46) A portion of the senior secured note is denominated in Canadian Dollars (CAD). As of June 30, 2014 and June 30, 2015, the principal balance of this note was CAD 37,422 and CAD 36,666, respectively. In accordance with ASC 830, this note was remeasured into our functional currency, US Dollars (USD), and is presented on our Consolidated Schedules of Investments in USD.

(47) On June 9, 2015, we provided additional debt and equity financing to support the recapitalization of Edmentum, Inc. (“Edmentum”). As part of the recapitalization, we exchanged 100% of the $50,000 second lien term loan previously outstanding for $26,365 of junior PIK notes and 370,964.14 Class A common units representing 37.1% equity ownership in Edmentum Ultimate Holdings, LLC. In addition, we invested $5,875 in senior PIK notes and committed $7,834 as part of a second lien revolving credit facility, of which $4,896 was funded at closing. On June 9, 2015, we determined that the impairment of Edmentum was other-than-temporary and recorded a realized loss of $22,116 for the amount that the amortized cost exceeded the fair value, reducing the amortized cost to $37,216.

(48) Co-investment with another fund managed by an affiliate of our investment adviser, Prospect Capital Management L.P. See Note 13 for further discussion.

See notes to consolidated financial statements.
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PROSPECT CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED SCHEDULES OF INVESTMENTS – (CONTINUED)
(in thousands, except share data)

Endnote Explanations as of June 30, 2015 and June 30, 2014 (Continued)

(49) As defined in the 1940 Act, we are deemed to "Control" these portfolio companies because we own more than 25% of the portfolio company's outstanding voting securities. Transactions during the year ended June 30, 2015 with these controlled investments were as follows:

Portfolio Company	Purchases*	Redemptions*	Sales	Interest income	Dividend income	Other income	Net realized gains (losses)	Net unrealized gains (losses)
Airmall Inc.	$—	$(47,580)	$(9,920)	$576	$—	$3,000	$(2,808)	$12,216
American Property REIT Corp.	(107,073)**	(8)	—	14,747	—	1,342	—	14,672
Appalachian Energy LLC	—	(2,050)	—	—	—	—	(2,050)	2,050
Arctic Energy Services, LLC	—	—	—	6,721	—	—	—	(750)
ARRM Services, Inc.	—	(19,337)	(27,213)	956	—	2,000	(23,560)	21,014
Borga, Inc.	—	—	(2,589)	—	—	—	(2,589)	2,741
BXC Company, Inc.	250	(750)	(16,949)	—	—	5	(16,949)	15,333
CCPI Inc.	—	(450)	—	3,332	—	525	—	8,635
Change Clean Energy Company, LLC	—	—	—	—	—	—	—	—
Coalbed, LLC	—	—	—	—	—	—	—	—
CP Energy Services Inc.	—	—	—	16,420	—	—	—	(41,927)
Credit Central Loan Company, LLC	—	(141)	—	7,375	159	1,220	—	6,777
Echelon Aviation LLC	5,800	(37,313)	(400)	6,895	—	—	—	8,226
Edmentum Ultimate Holdings, LLC	59,333	(22,116)	—	—	—	—	(22,116)	—
First Tower Finance Company LLC	—	1,929	—	52,900	1,929	—	—	40,765
Freedom Marine Solutions, LLC	—	—	—	4,461	—	—	—	(4,429)
Gulf Coast Machine & Supply Company	8,500	—	—	1,370	—	—	—	(16,041)
Harbortouch Payments, LLC	27,722	(5,426)	—	29,834	—	579	—	58,857
Manx Energy, Inc.	—	(50)	—	—	—	—	(50)	50
MITY, Inc.	2,500	(2,500)	—	5,783	—	—	(5)	1,068
National Property REIT Corp.	357,609**	(38,460)	—	30,611	—	1,959	—	24,317
Nationwide Loan Company LLC (f/k/a Nationwide Acceptance LLC)	2,814	—	—	3,005	4,425	—	—	4,163
NMMB, Inc.	383	—	—	1,521	—	—	—	5,372
R-V Industries, Inc.	—	(1,175)	—	3,018	298	—	—	(16,052)
United Property REIT Corp.	51,774**	(376)	—	5,893	—	2,345	—	8,631
Valley Electric Company, Inc.	—	—	—	4,991	—	—	—	(5,036)
	100	(2,956)	(975)	—	—	—	(3,246)	3,831

Vets Securing America, Inc.***								
Wolf Energy, LLC	—	(5,991)	—	—	—	—	(5,818)	2,414
Yatesville Coal Company, LLC	—	(1,449)	—	—	—	—	(1,449)	1,449
Total	$409,712	$(186,199)	$(58,046)	$200,409	$6,811	$12,975	$(80,640)	$158,346

(50) As defined in the 1940 Act, we are deemed to be an "Affiliated company" of these portfolio companies because we own more than 5% of the portfolio company's outstanding voting securities. Transactions during the year ended June 30, 2015 with these affiliated investments were as follows:

Portfolio Company	Purchases*	Redemptions*	Sales	Interest income	Dividend income	Other income	Net realized gains (losses)	Net unrealized gains (losses)
BNN Holdings Corp.	$ 44,000	$ (30,679)	$ —	$ 3,799	$ 778	$ 226	$ —	$ 503
Total	$ 44,000	$ (30,679)	$ —	$ 3,799	$ 778	$ 226	$ —	$ 503

* Purchase amounts do not include payment-in-kind interest. Redemption amounts include impairments. Redemption amounts do not include the cost basis adjustments resulting from consolidation on July 1, 2014.

** These amounts include the cost basis of investments transferred from APRC and UPRC to NPRC. (See Note 3 for details.)

*** During the year ended June 30, 2015, THS ceased operations and the VSA management team supervised both the continued operations of VSA and the wind-down of activities at THS.

See notes to consolidated financial statements.

PROSPECT CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED SCHEDULES OF INVESTMENTS – (CONTINUED)
(in thousands, except share data)

Endnote Explanations as of June 30, 2015 and June 30, 2014 (Continued)

(51) As defined in the 1940 Act, we are deemed to “Control” these portfolio companies because we own more than 25% of the portfolio company’s outstanding voting securities. Transactions during the year ended June 30, 2014 with these controlled investments were as follows:

Portfolio Company	Purchases*	Redemptions*	Sales	Interest income	Dividend income	Other income	Net realized gains (losses)	Net unrealized gains (losses)
AMU Holdings Inc.	$ 7,600	$ (593)	$ (972)	$ 6,579	$ 12,000	$ —	$ —	$ (15,694)
APH Property Holdings, LLC	163,747	(118,186) **	—	18,788	—	5,946	—	3,393
Arctic Oilfield Equipment USA, Inc.	60,876	—	—	1,050	—	1,713	—	238
ARRM Services, Inc.	25,000	(24,251)	—	(733)	—	148	—	(14,957)
BXC Company, Inc. (f/k/a BXC Holding Company)***	300	—	—	—	—	—	—	(3,796)
CCPI Holdings Inc.	—	(450)	—	3,312	500	71	—	(1,443)
CP Holdings of Delaware LLC	113,501	—	—	13,858	—	1,864	—	16,618
Credit Central Holdings of Delaware, LLC	2,500	(159)	—	7,845	4,841	521	—	(2,371)
Echelon Aviation LLC	92,628	—	—	2,809	—	2,771	—	—
Energy Solutions Holdings Inc.	16,000	(8,525)	—	8,245	—	2,480	—	(2,168)
First Tower Holdings of Delaware LLC	10,000	—	—	54,320	—	10,560	—	17,003
Gulf Coast Machine & Supply Company	28,450	(26,213)	—	1,449	—	—	—	(777)
Harbortouch Holdings of Delaware Inc.	278,694	—	—	6,879	—	7,536	—	12,620
The Healing Staff, Inc.	—	—	—	—	—	5,825	—	—
Manx Energy, Inc.	—	(450)	—	—	—	—	—	104
MITY Holdings of Delaware Inc.	47,985	—	—	4,693	—	1,049	—	1,127
Nationwide Acceptance Holdings LLC	4,000	—	—	4,429	5,000	1,854	—	772
NMMB Holdings, Inc.	8,086	(8,086)	—	2,051	—	—	—	(6,852)
NPH Property Holdings, LLC	40,425	85,724 **	—	5,973	—	1,029	—	(2,088)
R-V Industries, Inc.	—	(2,339)	—	3,188	1,100	—	—	2,005
STI Holding, Inc.	—	(125)	—	—	3,246	—	—	(25)
UPH Property Holdings, LLC	1,405	22,562 **	—	1,101	—	156	—	426
Valley Electric Holdings I, Inc.	—	(200)	—	7,471	—	148	—	(23,304)
Wolf Energy Holdings Inc.	—	—	—	—	—	—	—	(1,350)
Total	$ 901,197	$ (81,291)	$ (972)	$ 153,307	$ 26,687	$ 43,671	$ —	$ (20,519)

(52) As defined in the 1940 Act, we are deemed to be an “Affiliated company” of these portfolio companies because we own more than 5% of the portfolio company’s outstanding voting securities. Transactions during the year ended June 30, 2014 with these affiliated investments were as follows:

Portfolio Company	Purchases*	Redemptions*	Sales	Interest income	Dividend income	Other income	Net realized gains	Net unrealized gains

							(losses)	(losses)
BNN Holdings Corp.	$ —	$ (600)	$ —	$ 2,974	$ —	$ —	$ —	$ (194)
BXC Holding Company***	—	(100)	—	1,384	—	17	—	(4,163)
Smart, LLC	—	—	—	—	—	—	—	(143)
Total	$ —	$ (700)	$ —	$ 4,358	$ —	$ 17	$ —	$ (4,500)

* Purchase amounts do not include payment-in-kind interest. Redemption amounts include impairments.
** These amounts include the cost basis of investments transferred from APH to NPH and UPH.
*** During the year ended June 30, 2014, we acquired control of BXC Company, Inc. (f/k/a BXC Holding Company). As such, this investment was a controlled investment for part of the year and an affiliated investment for part of the year. See Note 14 for further discussion of this transaction.

See notes to consolidated financial statements.
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PROSPECT CAPITAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(in thousands, except share and per share data)

Note 1. Organization

In this report, the terms “Prospect,” “we,” “us” and “our” mean Prospect Capital Corporation and its subsidiaries unless the context specifically requires otherwise.

Prospect Capital Corporation is a financial services company that primarily lends to and invests in middle market privately-held companies. We are a closed-end investment company incorporated in Maryland. We have elected to be regulated as a business development company (“BDC”) under the Investment Company Act of 1940 (the “1940 Act”). As a BDC, we have elected to be treated as a regulated investment company (“RIC”), under Subchapter M of the Internal Revenue Code of 1986 (the “Code”). We were organized on April 13, 2004 and were funded in an initial public offering completed on July 27, 2004.

On May 15, 2007, we formed a wholly-owned subsidiary Prospect Capital Funding LLC (“PCF”), a Delaware limited liability company and a bankruptcy remote special purpose entity, which holds certain of our portfolio loan investments that are used as collateral for the revolving credit facility at PCF. Our wholly-owned subsidiary Prospect Small Business Lending, LLC (“PSBL”) was formed on January 27, 2014 and purchases small business whole loans on a recurring basis from online small business loan originators, including On Deck Capital, Inc. (“OnDeck”) and Direct Capital Corporation (“Direct Capital”). On September 30, 2014, we formed a wholly-owned subsidiary Prospect Yield Corporation, LLC (“PYC”) and effective October 23, 2014, PYC holds our investments in collateralized loan obligations (“CLOs”). Each of these subsidiaries have been consolidated since operations commenced.

Effective July 1, 2014, we began consolidating certain of our wholly-owned and substantially wholly-owned holding companies formed by us in order to facilitate our investment strategy. The following companies have been included in our consolidated financial statements since July 1, 2014: AMU Holdings Inc.; APH Property Holdings, LLC; Arctic Oilfield Equipment USA, Inc.; CCPI Holdings Inc.; CP Holdings of Delaware LLC; Credit Central Holdings of Delaware, LLC; Energy Solutions Holdings Inc.; First Tower Holdings of Delaware LLC; Harbortouch Holdings of Delaware Inc.; MITY Holdings of Delaware Inc.; Nationwide Acceptance Holdings LLC; NMMB Holdings, Inc.; NPH Property Holdings, LLC; STI Holding, Inc.; UPH Property Holdings, LLC; Valley Electric Holdings I, Inc.; Valley Electric Holdings II, Inc.; and Wolf Energy Holdings Inc. On October 10, 2014, concurrent with the sale of the operating company, our ownership increased to 100% of the outstanding equity of ARRM Services, Inc. which was renamed SB Forging Company, Inc. (“SB Forging”). As such, we began consolidating SB Forging on October 11, 2014. We collectively refer to these entities as the “Consolidated Holding Companies.”

We are externally managed by our investment adviser, Prospect Capital Management L.P. (“Prospect Capital Management” or the “Investment Adviser”). Prospect Administration LLC (“Prospect Administration” or the “Administrator”) provides administrative services and facilities necessary for us to operate.

Our investment objective is to generate both current income and long-term capital appreciation through debt and equity investments. We invest primarily in senior and subordinated debt and equity of private companies in need of capital for acquisitions, divestitures, growth, development, recapitalizations and other purposes. We work with the management teams or financial sponsors to seek investments with historical cash flows, asset collateral or contracted pro-forma cash flows.

Note 2. Significant Accounting Policies

Basis of Presentation and Consolidation

The accompanying consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles (“GAAP”) pursuant to the requirements for reporting on Form 10-K, ASC 946, Financial Services—Investment Companies (“ASC 946”), and Articles 6, 10 and 12 of Regulation S-X. Under the 1940 Act, ASC 946, and the regulations pursuant to Article 6 of Regulation S-X, we are precluded from consolidating any entity other than another investment company or an operating company which provides substantially all of its services to benefit us. Our consolidated financial statements include the accounts of Prospect, PCF, PSBL, PYC, and the Consolidated

Holding Companies. All intercompany balances and transactions have been eliminated in consolidation. The financial results of our non-substantially wholly-owned holding companies and operating portfolio company investments are not consolidated in the financial statements. Any operating companies owned by the Consolidated Holding Companies are not consolidated.

Use of Estimates

The preparation of the consolidated financial statements in accordance with GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of income, expenses, and gains and losses during the reported period. Changes in the economic environment, financial markets, creditworthiness of our portfolio companies and any other parameters used in determining these estimates could cause actual results to differ, and these differences could be material.

Cash and Cash Equivalents

Cash and cash equivalents include funds deposited with financial institutions and short-term, highly-liquid overnight investments in money market funds. Cash and cash equivalents are carried at cost which approximates fair value.

Investment Classification

We are a non-diversified company within the meaning of the 1940 Act. As required by the 1940 Act, we classify our investments by level of control. As defined in the 1940 Act, “Control Investments” are those where there is the ability or power to exercise a controlling influence over the management or policies of a company. Control is generally deemed to exist when a company or individual possesses or has the right to acquire within 60 days or less, a beneficial ownership of more than 25% of the voting securities of an investee company. Under the 1940 Act, “Affiliate Investments” are defined by a lesser degree of influence and are deemed to exist through the possession outright or via the right to acquire within 60 days or less, beneficial ownership of 5% or more of the outstanding voting securities of another person. “Non-Control/Non-Affiliate Investments” are those that are neither Control Investments nor Affiliate Investments.

Investments are recognized when we assume an obligation to acquire a financial instrument and assume the risks for gains or losses related to that instrument. Investments are derecognized when we assume an obligation to sell a financial instrument and forego the risks for gains or losses related to that instrument. Specifically, we record all security transactions on a trade date basis. Amounts for investments recognized or derecognized but not yet settled are reported in due to broker or as a receivable for investments sold in the consolidated statements of assets and liabilities.

Investment Risks

Our investments are subject to a variety of risks. Those risks include the following:

Market Risk

Market risk represents the potential loss that can be caused by a change in the fair value of the financial instrument.

Credit Risk

Credit risk represents the risk that we would incur if the counterparties failed to perform pursuant to the terms of their agreements with us.

Liquidity Risk

Liquidity risk represents the possibility that we may not be able to rapidly adjust the size of our investment positions in times of high volatility and financial stress at a reasonable price.

Interest Rate Risk

Interest rate risk represents a change in interest rates, which could result in an adverse change in the fair value of an interest-bearing financial instrument.

Prepayment Risk

Many of our debt investments allow for prepayment of principal without penalty. Downward changes in interest rates may cause prepayments to occur at a faster than expected rate, thereby effectively shortening the maturity of the security and making the security less likely to be an income producing instrument.

Investment Valuation

To value our investments, we follow the guidance of ASC 820, Fair Value Measurement ("ASC 820"), that defines fair value, establishes a framework for measuring fair value in conformity with GAAP, and requires disclosures about fair value measurements. In accordance with ASC 820, the fair value of our investments is defined as the price that we would receive upon selling an investment in an orderly transaction to an independent buyer in the principal or most advantageous market in which that investment is transacted.

ASC 820 classifies the inputs used to measure these fair values into the following hierarchy:

Level 1: Quoted prices in active markets for identical assets or liabilities, accessible by us at the measurement date.

Level 2: Quoted prices for similar assets or liabilities in active markets, or quoted prices for identical or similar assets or liabilities in markets that are not active, or other observable inputs other than quoted prices.

Level 3: Unobservable inputs for the asset or liability.

In all cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level of input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to each investment.

Our Board of Directors has established procedures for the valuation of our investment portfolio. These procedures are detailed below.

Investments for which market quotations are readily available are valued at such market quotations.

For most of our investments, market quotations are not available. With respect to investments for which market quotations are not readily available or when such market quotations are deemed not to represent fair value, our Board of Directors has approved a multi-step valuation process each quarter, as described below.

1. Each portfolio company or investment is reviewed by our investment professionals with independent valuation firms engaged by our Board of Directors.
2. The independent valuation firms conduct independent valuations and make their own independent assessments.
3. The Audit Committee of our Board of Directors reviews and discusses the preliminary valuation of the Investment Adviser and that of the independent valuation firms.
4. The Board of Directors discusses valuations and determines the fair value of each investment in our portfolio in good faith based on the input of the Investment Adviser, the respective independent valuation firm and the Audit Committee.

Our non-CLO investments are valued utilizing a yield analysis, enterprise value ("EV") analysis, net asset value analysis, liquidation analysis, discounted cash flow analysis, or a combination of methods, as appropriate. The yield analysis uses loan spreads for loans, dividend yields for certain investments and other relevant information implied by market data involving identical or comparable assets or liabilities. Under the EV analysis, the EV of a portfolio company is first determined and allocated over the portfolio company's securities in order of their preference relative to one another (i.e., "waterfall" allocation). To determine the EV, we typically use a market multiples approach that considers relevant and applicable market trading data of guideline public companies, transaction metrics from precedent M&A transactions and/or a discounted cash flow analysis. The net asset value analysis is used to derive a value of an underlying investment (such as real estate property) by dividing a relevant earnings stream by an appropriate capitalization rate. For this purpose, we consider capitalization rates for similar properties as may be obtained from guideline public companies and/or relevant transactions. The liquidation analysis is intended to approximate the net recovery value of an investment based on, among other things, assumptions regarding liquidation proceeds based on a hypothetical liquidation of a portfolio company's assets. The discounted cash flow analysis uses valuation techniques to convert future cash flows or earnings to a range of fair values from which a single estimate may be derived utilizing an appropriate discount rate. The measurement is based on the net present value indicated by current market expectations about those future amounts.

In applying these methodologies, additional factors that we consider in valuing our investments may include, as we deem relevant: security covenants, call protection provisions, and information rights; the nature and realizable value of any collateral; the portfolio company's ability to make payments; the principal markets in which the portfolio company does business; publicly available financial ratios of peer companies; the principal market; and enterprise values, among other factors.

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Our investments in CLOs are classified as ASC 820 Level 3 securities and are valued using a discounted cash flow model. The valuations have been accomplished through the analysis of the CLO deal structures to identify the risk exposures from the modeling point of view as well as to determine an appropriate call date. For each CLO security, the most appropriate valuation approach has been chosen from alternative approaches to ensure the most accurate valuation for such security. To value a CLO, both the assets and the liabilities of the CLO capital structure are modeled. We use a waterfall engine to store the collateral data, generate collateral cash flows from the assets based on various assumptions for the risk factors, distribute the cash flows to the liability structure based on the payment priorities, and discount them back using current market discount rates. The main risk factors are: default risk, interest rate risk, downgrade risk, and credit spread risk.

Valuation of Other Financial Assets and Financial Liabilities

ASC 825, Financial Instruments, specifically ASC 825-10-25, permits an entity to choose, at specified election dates, to measure eligible items at fair value (the "Fair Value Option"). We have not elected the Fair Value Option to report selected financial assets and financial liabilities. See Note 8 for further discussion of our financial liabilities that are measured using another measurement attribute.

Convertible Notes

We have recorded the Convertible Notes at their contractual amounts. The Convertible Notes were analyzed for any features that would require bifurcation and such features were determined to be immaterial. See Note 5 for further discussion.

Revenue Recognition

Realized gains or losses on the sale of investments are calculated using the specific identification method.

Interest income, adjusted for amortization of premium and accretion of discount, is recorded on an accrual basis. Origination, closing and/or commitment fees associated with investments in portfolio companies are accreted into interest income over the respective terms of the applicable loans. Accretion of such purchase discounts or amortization of premiums is calculated by the effective interest method as of the purchase date and adjusted only for material amendments or prepayments. Upon the prepayment of a loan or debt security, any prepayment penalties and unamortized loan origination, closing and commitment fees are recorded as interest income. The purchase discount for portfolio investments acquired from Patriot Capital Funding, Inc. ("Patriot") was determined based on the difference between par value and fair value as of December 2, 2009, and continued to accrete until maturity or repayment of the respective loans. As of December 31, 2013, the purchase discount for the assets acquired from Patriot had been fully accreted. See Note 3 for further discussion.

Loans are placed on non-accrual status when there is reasonable doubt that principal or interest will be collected. Unpaid accrued interest is generally reversed when a loan is placed on non-accrual status. Interest payments received on non-accrual loans may be recognized as income or applied to principal depending upon management's judgment. Non-accrual loans are restored to accrual status when past due principal and interest is paid and in management's judgment, is likely to remain current. As of June 30, 2015, approximately 0.1% of our total assets are in non-accrual status.

Interest income from investments in the "equity" class of security of CLO funds (typically income notes or subordinated notes) is recorded based upon an estimation of an effective yield to expected maturity utilizing assumed cash flows in accordance with ASC 325-40, Beneficial Interests in Securitized Financial Assets. We monitor the expected cash inflows from our CLO equity investments, including the expected residual payments, and the effective yield is determined and updated periodically.

Dividend income is recorded on the ex-dividend date.

Structuring fees and similar fees are recognized as income as earned, usually when paid. Structuring fees, excess deal deposits, net profits interests and overriding royalty interests are included in other income. See Note 10 for further discussion.

Federal and State Income Taxes
We have elected to be treated as a regulated investment company and intend to continue to comply with the requirements of the Code applicable to regulated investment companies. We are required to distribute at least 90% of our investment company taxable income and intend to distribute (or retain through a deemed distribution) all of our investment company taxable income and net capital gain to stockholders; therefore, we have made no provision for income taxes. The character of income and gains that we will distribute is determined in accordance with income tax regulations that may differ from GAAP. Book and tax basis differences relating to stockholder dividends and distributions and other permanent book and tax differences are reclassified to paid-in capital.
If we do not distribute (or are not deemed to have distributed) at least 98% of our annual ordinary income and 98.2% of our capital gains in the calendar year earned, we will generally be required to pay an excise tax equal to 4% of the amount by which 98% of our annual ordinary income and 98.2% of our capital gains exceed the distributions from such taxable income for the year. To the extent that we determine that our estimated current year annual taxable income will be in excess of estimated current year dividend distributions from such taxable income, we accrue excise taxes, if any, on estimated excess taxable income. For the calendar year ended December 31, 2014, we incurred an excise tax expense of $461 because our annual taxable income exceeded our distributions. As of June 30, 2015, we had a payable of $305 for excise taxes as our expected excise tax liability exceeded our excise tax payments through June 30, 2015. This amount is included within accrued expenses on the Consolidated Statement of Assets and Liabilities as of June 30, 2015.
If we fail to satisfy the annual distribution requirement or otherwise fail to qualify as a RIC in any taxable year, we would be subject to tax on all of our taxable income at regular corporate rates. We would not be able to deduct distributions to stockholders, nor would we be required to make distributions. Distributions would generally be taxable to our individual and other non-corporate taxable stockholders as ordinary dividend income eligible for the reduced maximum rate applicable to qualified dividend income to the extent of our current and accumulated earnings and profits, provided certain holding period and other requirements are met. Subject to certain limitations under the Code, corporate distributions would be eligible for the dividends-received deduction. To qualify again to be taxed as a RIC in a subsequent year, we would be required to distribute to our shareholders our accumulated earnings and profits attributable to non-RIC years reduced by an interest charge of 50% of such earnings and profits payable by us as an additional tax. In addition, if we failed to qualify as a RIC for a period greater than two taxable years, then, in order to qualify as a RIC in a subsequent year, we would be required to elect to recognize and pay tax on any net built-in gain (the excess of aggregate gain, including items of income, over aggregate loss that would have been realized if we had been liquidated) or, alternatively, be subject to taxation on such built-in gain recognized for a period of ten years.
We follow ASC 740, Income Taxes (“ASC 740”). ASC 740 provides guidance for how uncertain tax positions should be recognized, measured, presented, and disclosed in the consolidated financial statements. ASC 740 requires the evaluation of tax positions taken or expected to be taken in the course of preparing our tax returns to determine whether the tax positions are “more-likely-than-not” of being sustained by the applicable tax authority. Tax positions not deemed to meet the more-likely-than-not threshold are recorded as a tax benefit or expense in the current year. As of June 30, 2014 and June 30, 2015 and for the years then ended, we did not have a liability for any unrecognized tax benefits. Management’s determinations regarding ASC 740 may be subject to review and adjustment at a later date based upon factors including, but not limited to, an on-going analysis of tax laws, regulations and interpretations thereof. Although we file both federal and state income tax returns, our major tax jurisdiction is federal. Our tax returns for our federal tax years ending August 31, 2012 and thereafter remain subject to examination by the Internal Revenue Service.
Dividends and Distributions
Dividends and distributions to common stockholders are recorded on the ex-dividend date. The amount, if any, to be paid as a monthly dividend or distribution is approved by our Board of Directors quarterly and is generally based upon our management’s estimate of our future earnings. Net realized capital gains, if any, are distributed at least annually.
Financing Costs
We record origination expenses related to our Revolving Credit Facility and Convertible Notes, Public Notes and Prospect Capital InterNotes® (collectively, our “Unsecured Notes”) as deferred financing costs. These expenses are deferred and amortized as part of interest expense using the straight-line method for our Revolving Credit Facility and

the effective interest method for our Unsecured Notes over the respective expected life or maturity. In the event that we modify or extinguish our debt before maturity, we follow the guidance in ASC 470-50, Modification and Extinguishments (“ASC 470-50”). For modifications to or exchanges of our Revolving Credit Facility, any unamortized deferred costs relating to lenders who are not part of the new lending group are expensed. For extinguishments of our Unsecured Notes, any unamortized deferred costs are deducted from the carrying amount of the debt in determining the gain or loss from the extinguishment.

We record registration expenses related to shelf filings as prepaid assets. These expenses consist principally of SEC registration fees, legal fees and accounting fees incurred. These prepaid assets are charged to capital upon the receipt of proceeds from an equity offering or charged to expense if no offering is completed.

Guarantees and Indemnification Agreements

We follow ASC 460, Guarantees ("ASC 460"). ASC 460 elaborates on the disclosure requirements of a guarantor in its interim and annual consolidated financial statements about its obligations under certain guarantees that it has issued. It also requires a guarantor to recognize, at the inception of a guarantee, for those guarantees that are covered by ASC 460, the fair value of the obligation undertaken in issuing certain guarantees.

Per Share Information

Net increase or decrease in net assets resulting from operations per share is calculated using the weighted average number of common shares outstanding for the period presented. In accordance with ASC 946, convertible securities are not considered in the calculation of net asset value per share.

Recent Accounting Pronouncements

In August 2014, the FASB issued Accounting Standards Update 2014-15, Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern ("ASU 2014-15"). ASU 2014-15 will explicitly require management to assess an entity's ability to continue as a going concern, and to provide related footnote disclosure in certain circumstances. ASU 2014-15 is effective for annual and interim periods ending after December 15, 2016. Early application is permitted. The adoption of the amended guidance in ASU 2014-15 is not expected to have a significant effect on our consolidated financial statements and disclosures.

In January 2015, the FASB issued Accounting Standards Update 2015-01, Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items ("ASU 2015-01"). ASU 2015-01 simplifies income statement presentation by eliminating the need to determine whether to classify an item as an extraordinary item. ASU 2015-01 is effective for annual and interim periods beginning after December 15, 2015. Early adoption is permitted; however, adoption must occur at the beginning of an annual period. The adoption of the amended guidance in ASU 2015-01 is not expected to have a significant effect on our consolidated financial statements and disclosures.

In February 2015, the FASB issued Accounting Standards Update 2015-02, Amendments to the Consolidation Analysis ("ASU 2015-02"). ASU 2015-02 eliminates the deferral of FAS 167, which allowed reporting entities with interests in certain investment funds to follow the previous consolidation guidance in FIN 46(R), and makes other changes to both the variable interest model and the voting model. ASU 2015-02 is effective for annual and interim periods beginning after December 15, 2015. Early adoption is permitted, including adoption in an interim period. A reporting entity may apply the amendments using a modified retrospective approach by recording a cumulative-effect adjustment to equity as of the beginning of the period of adoption or may apply the amendments retrospectively. We are currently evaluating the effect the adoption of the amended guidance in ASU 2015-02 may have on our consolidated financial statements and disclosures.

In April 2015, the FASB issued Accounting Standards Update 2015-03, Simplifying the Presentation of Debt Issuance Costs ("ASU 2015-03"). ASU 2015-03 requires debt issuance costs related to a recognized debt liability to be presented in the balance sheet as a direct deduction from the debt liability rather than as an asset. The new guidance will make the presentation of debt issuance costs consistent with the presentation of debt discounts or premiums. ASU 2015-03 is effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption is permitted for financial statements that have not been previously issued. The new guidance must be applied on a retrospective basis to all prior periods presented in the financial statements. The adoption of the amended guidance in ASU 2015-03 is not expected to have a significant effect on our consolidated financial statements and disclosures.

Note 3. Portfolio Investments

At June 30, 2015, we had investments in 131 long-term portfolio investments, which had an amortized cost of $6,559,376 and a fair value of $6,609,558. At June 30, 2014, we had investments in 142 long-term portfolio investments, which had an amortized cost of $6,371,522 and a fair value of $6,253,739.

The original cost basis of debt placements and equity securities acquired, including follow-on investments for existing portfolio companies, totaled $2,088,988 and $2,952,356 during the years ended June 30, 2015 and June 30, 2014, respectively. Debt repayments and proceeds from sales of equity securities of approximately $1,633,073 and $786,969 were received during the years ended June 30, 2015 and June 30, 2014, respectively.

The following table shows the composition of our investment portfolio as of June 30, 2015 and June 30, 2014.

	June 30, 2015		June 30, 2014	
	Cost	Fair Value	Cost	Fair Value
Revolving Line of Credit	$30,546	$30,546	$3,445	$2,786
Senior Secured Debt	3,617,111	3,533,447	3,578,339	3,514,198
Subordinated Secured Debt	1,234,701	1,205,303	1,272,275	1,200,221
Subordinated Unsecured Debt	145,644	144,271	85,531	85,531
Small Business Loans	50,558	50,892	4,637	4,252
CLO Debt	28,613	32,398	28,118	33,199
CLO Residual Interest	1,072,734	1,113,023	1,044,656	1,093,985
Equity	379,469	499,678	354,521	319,567
Total Investments	$6,559,376	$6,609,558	$6,371,522	$6,253,739

In the previous table and throughout the remainder of this footnote, we aggregate our portfolio investments by type of investment, which may differ slightly from the nomenclature used by the constituent instruments defining the rights of holders of the investment, as disclosed on our Consolidated Schedules of Investments (“SOI”). The following investments are included in each category:

- Senior Secured Debt includes investments listed on the SOI such as senior secured term loans, senior term loans, secured promissory notes, senior demand notes, and first lien term loans.
- Subordinated Secured Debt includes investments listed on the SOI such as subordinated secured term loans, subordinated term loans, senior subordinated notes, and second lien term loans.
- Subordinated Unsecured Debt includes investments listed on the SOI such as subordinated unsecured notes and senior unsecured notes.
- Small Business Loans includes our investments in small business whole loans purchased from OnDeck and Direct Capital.
- CLO Debt includes our investments in the “debt” class of security of CLO funds.
- CLO Residual Interest includes our investments in the “equity” class of security of CLO funds such as income notes, preference shares, and subordinated notes.
- Equity includes our investments in preferred stock, common stock, membership interests, net profits interests, net operating income interests, net revenue interests, overriding royalty interests, escrows receivable, and warrants, unless specifically stated otherwise.

The following table shows the fair value of our investments disaggregated into the three levels of the ASC 820 valuation hierarchy as of June 30, 2015.

	Level 1	Level 2	Level 3	Total
Revolving Line of Credit	$—	$ —	$30,546	$30,546
Senior Secured Debt	—	—	3,533,447	3,533,447
Subordinated Secured Debt	—	—	1,205,303	1,205,303
Subordinated Unsecured Debt	—	—	144,271	144,271
Small Business Loans	—	—	50,892	50,892
CLO Debt	—	—	32,398	32,398
CLO Residual Interest	—	—	1,113,023	1,113,023
Equity	260	—	499,418	499,678
Total Investments	$260	$ —	$6,609,298	$6,609,558

The following table shows the fair value of our investments disaggregated into the three levels of the ASC 820 valuation hierarchy as of June 30, 2014.

	Level 1	Level 2	Level 3	Total
Revolving Line of Credit	$—	$ —	$2,786	$2,786
Senior Secured Debt	—	—	3,514,198	3,514,198
Subordinated Secured Debt	—	—	1,200,221	1,200,221
Subordinated Unsecured Debt	—	—	85,531	85,531
Small Business Loans	—	—	4,252	4,252
CLO Debt	—	—	33,199	33,199
CLO Residual Interest	—	—	1,093,985	1,093,985
Equity	168	—	319,399	319,567
Total Investments	$168	$ —	$6,253,571	$6,253,739

The following tables show the aggregate changes in the fair value of our Level 3 investments during the year ended June 30, 2015.

	Fair Value Measurements Using Unobservable Inputs (Level 3)			
	Control Investments	Affiliate Investments	Non-Control/ Non-Affiliate Investments	Total
Fair value as of June 30, 2014	$ 1,640,454	$ 32,121	$ 4,580,996	$ 6,253,571
Net realized losses on investments	(80,640)	—	(99,836)	(180,476)
Net change in unrealized appreciation	158,346	503	9,024	167,873
Net realized and unrealized gains (losses)	77,706	503	(90,812)	(12,603)
Purchases of portfolio investments	409,712	44,000	1,605,999	2,059,711
Payment-in-kind interest	22,850	—	6,427	29,277
Amortization of discounts and premiums	—	—	(87,638)	(87,638)
Repayments and sales of portfolio investments	(176,520)	(30,679)	(1,425,821)	(1,633,020)
Transfers within Level 3(1)	—	—	—	—
Transfers in (out) of Level 3(1)	—	—	—	—
Fair value as of June 30, 2015	$ 1,974,202	$ 45,945	$ 4,589,151	$ 6,609,298

	Revolving Line of Credit	Senior Secured Debt	Subordinated Secured Debt	Subordinated Unsecured Debt	Small Business Loans	CLO Debt	CLO Residual Interest	Equity	Total
Fair value as of June 30, 2014	$2,786	$3,514,198	$1,200,221	$85,531	$4,252	$33,199	$1,093,985	$319,399	$6,253,571
Net realized losses on investments	(1,095)	(36,955)	(77,745)	(6,502)	(2,490)	—	(15,561)	(40,128)	(180,476)
Net change in unrealized appreciation (depreciation)	659	(19,521)	42,658	(1,374)	719	(1,296)	(9,043)	155,071	167,873
Net realized and unrealized (losses) gains	(436)	(56,476)	(35,087)	(7,876)	(1,771)	(1,296)	(24,604)	114,943	(12,603)
Purchases of portfolio investments	58,196	1,234,738	314,767	38,834	96,614	—	220,779	95,783	2,059,711
Payment-in-kind interest	—	25,695	1,412	2,170	—	—	—	—	29,277
Accretion (amortization) of discounts and premiums	—	314	3,617	—	—	495	(92,064)	—	(87,638)
Repayments and sales of portfolio investments	(30,000)	(1,185,022)	(254,627)	612	(48,203)	—	(85,073)	(30,707)	(1,633,020)
Transfers within Level 3(1)	—	—	(25,000)	25,000	—	—	—	—	—
Transfers in (out) of Level 3(1)	—	—	—	—	—	—	—	—	—

Fair value as of June 30, 2015	$30,546	$3,533,447	$1,205,303	$144,271	$50,892	$32,398	$1,113,023	$499,418	$6,609,298

(1) Transfers are assumed to have occurred at the beginning of the quarter during which the asset was transferred.

The following tables show the aggregate changes in the fair value of our Level 3 investments during the year ended June 30, 2014.

	Fair Value Measurements Using Unobservable Inputs (Level 3)			
	Control Investments	Affiliate Investments	Non-Control/ Non-Affiliate Investments	Total
Fair value as of June 30, 2013	$ 811,634	$ 42,443	$ 3,318,663	$ 4,172,740
Net realized losses on investments	—	—	(3,346)	(3,346)
Net change in unrealized depreciation	(20,519)	(4,500)	(9,894)	(34,913)
Net realized and unrealized losses	(20,519)	(4,500)	(13,240)	(38,259)
Purchases of portfolio investments	901,197	—	2,036,014	2,937,211
Payment-in-kind interest	11,796	90	3,259	15,145
Accretion (amortization) of discounts and premiums	—	399	(46,696)	(46,297)
Repayments and sales of portfolio investments	(82,263)	(700)	(704,006)	(786,969)
Transfers within Level 3(1)	18,609	(5,611)	(12,998)	—
Transfers in (out) of Level 3(1)	—	—	—	—
Fair value as of June 30, 2014	$ 1,640,454	$ 32,121	$ 4,580,996	$ 6,253,571

	Revolving Line of Credit	Senior Secured Debt	Subordinated Secured Debt	Subordinated Unsecured Debt	Small Business Loans	CLO Debt	CLO Residual Interest	Equity	Total
Fair value as of June 30, 2013	$8,729	$2,207,091	$1,024,901	$88,827	$—	$28,589	$658,086	$156,517	$4,172,740
Net realized (losses) gains on investments	—	(1,593)	(7,558)	—	—	—	1,183	4,622	(3,346)
Net change in unrealized (depreciation) appreciation	(150)	(8,907)	(34,566)	(357)	(386)	4,159	51,864	(46,570)	(34,913)
Net realized and unrealized (losses) gains	(150)	(10,500)	(42,124)	(357)	(386)	4,159	53,047	(41,948)	(38,259)
Purchases of portfolio investments	14,850	1,692,284	554,973	—	6,540	—	453,492	215,072	2,937,211
Payment-in-kind interest	—	13,850	428	867	—	—	—	—	15,145
Accretion (amortization) of discounts and premiums	—	683	2,065	73	—	451	(49,569)	—	(46,297)
Repayments and sales of portfolio investments	(20,643)	(389,210)	(270,022)	(73,879)	(1,902)	—	(21,071)	(10,242)	(786,969)
Transfers within Level 3(1)	—	—	(70,000)	70,000	—	—	—	—	—
Transfers in (out) of Level 3(1)	—	—	—	—	—	—	—	—	—

Fair value as of June 30, 2014	$2,786	$3,514,198	$1,200,221	$85,531	$4,252	$33,199	$1,093,985	$319,399	$6,253,571

(1) Transfers are assumed to have occurred at the beginning of the quarter during which the asset was transferred.

For the years ended June 30, 2015 and June 30, 2014, the net change in unrealized appreciation (depreciation) on the investments that use Level 3 inputs was $82,432 and $(27,973) for investments still held as of June 30, 2015 and June 30, 2014, respectively.

The ranges of unobservable inputs used in the fair value measurement of our Level 3 investments as of June 30, 2015 were as follows:

			Unobservable Input		
Asset Category	Fair Value	Primary Valuation Technique	Input	Range	Weighted Average
Senior Secured Debt	$2,421,188	Yield Analysis	Market Yield	6.1%-21.4%	11.3%
Senior Secured Debt	563,050	EV Analysis	EBITDA Multiple	3.5x-11.0x	8.1x
Senior Secured Debt(1)	64,560	EV Analysis	Loss-Adjusted Discount Rate	3.8%-10.7%	6.9%
Senior Secured Debt(2)	98,025	EV Analysis	Loss-Adjusted Discount Rate	5.4%-16.3%	10.0%
Senior Secured Debt	40,808	EV Analysis	Discount Rate	7.0%-9.0%	8.0%
Senior Secured Debt	25,970	EV Analysis	Appraisal	N/A	N/A
Senior Secured Debt	6,918	Liquidation Analysis	N/A	N/A	N/A
Senior Secured Debt	343,474	Net Asset Value Analysis	Capitalization Rate	5.6%-7.0%	6.0%
Subordinated Secured Debt	847,624	Yield Analysis	Market Yield	8.1%-18.3%	12.5%
Subordinated Secured Debt	54,948	EV Analysis	EBITDA Multiple	3.5x-6.0x	4.7x
Subordinated Secured Debt	302,731	EV Analysis	Book Value Multiple	1.2x-3.8x	2.7x
Subordinated Unsecured Debt	112,701	Yield Analysis	Market Yield	9.1%-15.3%	11.8%
Subordinated Unsecured Debt	31,570	EV Analysis	EBITDA Multiple	5.8x-8.0x	7.2x
Small Business Loans(3)	362	Discounted Cash Flow	Loss-Adjusted Discount Rate	11.7%-27.3%	23.5%
Small Business Loans(4)	50,530	Discounted Cash Flow	Loss-Adjusted Discount Rate	20.4%-33.2%	24.9%
CLO Debt	32,398	Discounted Cash Flow	Discount Rate	6.1%-6.9%	6.5%
CLO Residual Interest	1,113,023	Discounted Cash Flow	Discount Rate	11.2%-18.0%	14.0%
Equity	139,424	EV Analysis	EBITDA Multiple	2.0x-11.0x	8.5x
Equity	148,631	EV Analysis	Book Value Multiple	1.2x-3.8x	2.5x
Equity	1,120	EV Analysis	Appraisal	N/A	N/A
Equity	3,023	Yield Analysis	Market Yield	19.8%-24.7%	22.2%
Equity	130,316	Net Asset Value Analysis	Capitalization Rate	5.6%-7.0%	5.9%
Equity	28,133	Discounted Cash Flow	Discount Rate	7.0%-9.0%	8.0%
Participating Interest(5)	42,765	Yield Analysis	Market Yield	11.5%-18.0%	12.5%
Participating Interest(5)	22	Liquidation Analysis	N/A	N/A	N/A
Escrow Receivable	5,984	Discounted Cash Flow	Discount Rate	7.0%-8.2%	7.6%
Total Level 3 Investments	$6,609,298				

(1) EV analysis is based on the fair value of our investments in consumer loans purchased from Prosper, which are valued using a discounted cash flow valuation technique. The key unobservable input to the discounted cash flow analysis is noted above. In addition, the valuation also used projected loss rates as an unobservable input ranging from 0.6%-26.5%, with a weighted average of 8.4%.

(2) EV analysis is based on the fair value of our investments in consumer loans purchased from Lending Club, which are valued using a discounted cash flow valuation technique. The key unobservable input to the discounted cash flow analysis is noted above. In addition, the valuation also used projected loss rates as an unobservable input ranging from 2.3%-23.8%, with a weighted average of 16.9%.

(3) Includes our investments in small business whole loans purchased from Direct Capital. Valuation also used projected loss rates as an unobservable input ranging from 0.03%-60.0%, with a weighted average of 42.3%.

(4) Includes our investments in small business whole loans purchased from OnDeck. Valuation also used projected loss rates as an unobservable input ranging from 4.2%-11.7%, with a weighted average of 9.7%.

(5) Participating Interest includes our participating equity investments, such as net profits interests, net operating income interests, net revenue interests, and overriding royalty interests.

The ranges of unobservable inputs used in the fair value measurement of our Level 3 investments as of June 30, 2014 were as follows:

			Unobservable Input		
Asset Category	Fair Value	Primary Valuation Technique	Input	Range	Weighted Average
Senior Secured Debt	$2,550,073	Yield Analysis	Market Yield	5.5%-20.3%	11.1%
Senior Secured Debt	560,485	EV Analysis	EBITDA Multiple	3.5x-9.0x	7.1x
Senior Secured Debt	110,525	EV Analysis	Other	N/A	N/A
Senior Secured Debt	3,822	Liquidation Analysis	N/A	N/A	N/A
Senior Secured Debt	292,079	Net Asset Value Analysis	Capitalization Rate	4.5%-10.0%	7.4%
Subordinated Secured Debt	832,181	Yield Analysis	Market Yield	8.7%-14.7%	10.9%
Subordinated Secured Debt	353,220	EV Analysis	EBITDA Multiple	4.5x-8.2x	6.2x
Subordinated Secured Debt	14,820	EV Analysis	Book Value Multiple	1.2x-1.4x	1.3x
Subordinated Unsecured Debt	85,531	Yield Analysis	Market Yield	7.4%-14.4%	12.1%
Small Business Loans	4,252	Yield Analysis	Market Yield	75.5%-79.5%	77.5%
CLO Debt	33,199	Discounted Cash Flow	Discount Rate	4.2%-5.8%	4.9%
CLO Residual Interest	1,093,985	Discounted Cash Flow	Discount Rate	10.4%-23.7%	16.8%
Equity	222,059	EV Analysis	EBITDA Multiple	2.0x-15.3x	5.3x
Equity	15,103	EV Analysis	Book Value Multiple	1.2x-1.4x	1.3x
Equity	3,171	Yield Analysis	Market Yield	13.7%-16.5%	15.1%
Equity	63,157	Net Asset Value Analysis	Capitalization Rate	4.5%-10.0%	7.4%
Equity	14,107	Discounted Cash Flow	Discount Rate	8.0%-10.0%	9.0%
Participating Interest(1)	213	Liquidation Analysis	N/A	N/A	N/A
Escrow Receivable	1,589	Discounted Cash Flow	Discount Rate	6.6%-7.8%	7.2%
Total Level 3 Investments	$6,253,571				

(1) Participating Interest includes our participating equity investments, such as net profits interests, net operating income interests, net revenue interests, and overriding royalty interests.

In determining the range of value for debt instruments except CLOs and debt investments in controlling portfolio companies, management and the independent valuation firm generally estimated corporate and security credit ratings and identified corresponding yields to maturity for each loan from relevant market data. A discounted cash flow analysis was then prepared using the appropriate yield to maturity as the discount rate, to determine range of value. For non-traded equity investments, the enterprise value was determined by applying earnings before income tax, depreciation and amortization ("EBITDA") multiples, net income multiples, or book value multiples for similar guideline public companies and/or similar recent investment transactions. For stressed equity investments, a liquidation analysis was prepared. For the private REIT investments, enterprise values were determined based on an average of results from a net asset value analysis of the underlying property investments and a dividend yield analysis utilizing capitalization rates and dividend yields, respectively, for similar guideline companies and/or similar recent investment transactions.

In determining the range of value for our investments in CLOs, management and the independent valuation firm used a discounted cash flow model. The valuations were accomplished through the analysis of the CLO deal structures to identify the risk exposures from the modeling point of view as well as to determine an appropriate call date. For each CLO security, the most appropriate valuation approach was chosen from alternative approaches to ensure the most accurate valuation for such security. A waterfall engine was used to store the collateral data, generate collateral cash flows from the assets based on various assumptions for the risk factors, distribute the cash flows to the liability structure based on the payment priorities, and discount them back using proper discount rates to expected maturity or call date.

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CLO investments may be riskier and less transparent to us than direct investments in underlying companies. CLOs typically will have no significant assets other than their underlying senior secured loans. Therefore, payments on CLO investments are and will be payable solely from the cash flows from such senior secured loans. Our CLO investments are exposed to leveraged credit risk. If certain minimum collateral value ratios and/or interest coverage ratios are not met by a CLO, primarily due to senior secured loan defaults, then cash flow that otherwise would have been available to pay distributions to us on our CLO investments may instead be used to redeem any senior notes or to purchase additional senior secured loans, until the ratios again exceed the minimum required levels or any senior notes are repaid in full. Our CLO investments and/or the underlying senior secured loans may prepay more quickly than expected, which could have an adverse impact on our value. We are not responsible for and have no influence over the asset management of the portfolios underlying the CLO investments we hold as those portfolios are managed by non-affiliated third party CLO collateral managers.

The significant unobservable input used to value our investments based on the yield analysis and discounted cash flow analysis is the market yield (or applicable discount rate) used to discount the estimated future cash flows expected to be received from the underlying investment, which includes both future principal and interest/dividend payments. Increases or decreases in the market yield (or applicable discount rate) would result in a decrease or increase, respectively, in the fair value measurement. Management and the independent valuation firm consider the following factors when selecting market yields or discount rates: risk of default, rating of the investment and comparable company investments, and call provisions.

The significant unobservable inputs used to value our investments based on the EV analysis may include market multiples of specified financial measures such as EBITDA, net income, or book value of identified guideline public companies, implied valuation multiples from precedent M&A transactions, and/or discount rates applied in a discounted cash flow analysis. The independent valuation firm identifies a population of publicly traded companies with similar operations and key attributes to that of the portfolio company. Using valuation and operating metrics of these guideline public companies and/or as implied by relevant precedent transactions, a range of multiples of the latest twelve months EBITDA, or other measure such as net income or book value, is typically calculated. The independent valuation firm utilizes the determined multiples to estimate the portfolio company’s EV generally based on the latest twelve months EBITDA of the portfolio company (or other meaningful measure). Increases or decreases in the multiple may result in an increase or decrease, respectively, in EV which may increase or decrease the fair value measurement of the debt and/or equity investment, as applicable. In certain instances, a discounted cash flow analysis may be considered in estimating EV, in which case, discount rates based on a weighted average cost of capital and application of the Capital Asset Pricing Model may be utilized.

The significant unobservable input used to value our investments based on the net asset value analysis is the capitalization rate applied to the earnings measure of the underlying property. Increases or decreases in the capitalization rate would result in a decrease or increase, respectively, in the fair value measurement.

Changes in market yields, discount rates, capitalization rates or EBITDA multiples, each in isolation, may change the fair value measurement of certain of our investments. Generally, an increase in market yields, discount rates or capitalization rates, or a decrease in EBITDA (or other) multiples may result in a decrease in the fair value measurement of certain of our investments.

Due to the inherent uncertainty of determining the fair value of investments that do not have a readily available market value, the fair value of our investments may fluctuate from period to period. Additionally, the fair value of our investments may differ significantly from the values that would have been used had a ready market existed for such investments and may differ materially from the values that we may ultimately realize. Further, such investments are generally subject to legal and other restrictions on resale or otherwise are less liquid than publicly traded securities. If we were required to liquidate a portfolio investment in a forced or liquidation sale, we could realize significantly less than the value at which we have recorded it.

In addition, changes in the market environment and other events that may occur over the life of the investments may cause the gains or losses ultimately realized on these investments to be different than the unrealized gains or losses reflected in the currently assigned valuations.

During the year ended June 30, 2015, the valuation methodology for American Gilsonite Company (“AGC”) changed to incorporate secondary trade data in addition to the yield analysis used in previous periods. As a result of this change,

and in recognition of recent company performance and current market conditions, we decreased the fair value of our investment in AGC to $14,287 as of June 30, 2015, a discount of $1,468 from its amortized cost, compared to the $3,477 unrealized appreciation recorded at June 30, 2014.

During the year ended June 30, 2015, the valuation methodology for CCPI Inc. ("CCPI") changed to solely an EV analysis by removing the discounted cash flow used in previous periods. Management adopted this change due to a lack of long-term forecasts for CCPI. As a result of this change, and in recognition of recent company performance and current market conditions, we increased the fair value of our investment in CCPI to $41,352 as of June 30, 2015, a premium of $7,192 to its amortized cost, compared to the $1,443 unrealized depreciation recorded at June 30, 2014.

During the year ended June 30, 2015, the valuation methodology for Edmentum, Inc. ("Edmentum") changed to an EV analysis in place of the yield analysis used in previous periods. Management adopted this change due to the company's debt restructuring in June 2015, through which Prospect became the largest shareholder of the company. As a result of this change, and in recognition of recent company performance and subsequent other-than-temporary impairment, we decreased the fair value of our investment in Edmentum to $37,216 as of June 30, 2015, equal to its amortized cost, compared to the $1,561 unrealized appreciation recorded at June 30, 2014.

During the year ended June 30, 2015, the valuation methodology for Empire Today, LLC ("Empire Today") changed to incorporate an EV analysis and secondary trade data in addition to the yield analysis used in previous periods. Management adopted the EV analysis due to a deterioration in operating results and resulting credit impairment. As a result of this change, and in recognition of recent company performance and current market conditions, we decreased the fair value of our investment in Empire Today to $13,070 as of June 30, 2015, a discount of $2,448 from its amortized cost, compared to the $281 unrealized appreciation recorded at June 30, 2014.

During the year ended June 30, 2015, the valuation methodology for Gulf Coast Machine & Supply Company ("Gulf Coast") changed to a liquidation analysis in place of the EV analysis used in previous periods. Management adopted the liquidation analysis due to a deterioration in operating results, resulting credit impairment, and the unavailability of revised budget figures. As a result of this change, and in recognition of recent company performance and current market conditions, we decreased the fair value of our investment in Gulf Coast to $6,918 as of June 30, 2015, a discount of $45,032 from its amortized cost, compared to the $28,991 unrealized depreciation recorded at June 30, 2014.

During the year ended June 30, 2015, the valuation methodology for ICON Health & Fitness, Inc. ("ICON") changed to incorporate secondary trade data in addition to the yield analysis used in previous periods. As a result of this change, and in recognition of recent company performance and current market conditions, we increased the fair value of our investment in ICON to $16,100 as of June 30, 2015, a discount of $3 from its amortized cost, compared to the $1,116 unrealized depreciation recorded at June 30, 2014.

During the year ended June 30, 2015, the valuation methodology for Prince Mineral Holding Corp. ("Prince") changed to incorporate secondary trade data in addition to the yield analysis used in previous periods. As a result of this change, and in recognition of recent company performance and current market conditions, we decreased the fair value of our investment in Prince to $9,458 as of June 30, 2015, a discount of $457 from its amortized cost, compared to the $98 unrealized appreciation recorded at June 30, 2014.

During the year ended June 30, 2015, the valuation methodology for Targus Group International, Inc. ("Targus") changed to incorporate an EV analysis in place of the yield analysis used in previous periods. Management adopted the EV analysis due to a deterioration in operating results and resulting credit impairment. As a result of this change, and in recognition of recent company performance and current market conditions, we decreased the fair value of our investment in Targus to $17,233 as of June 30, 2015, a discount of $4,145 from its amortized cost, compared to the $1,748 unrealized depreciation recorded at June 30, 2014.

During the year ended June 30, 2015, the valuation methodology for United Sporting Companies, Inc. ("USC") changed to incorporate an EV analysis in addition to the yield analysis used in previous periods. Management adopted the EV analysis due to a deterioration in operating results and resulting credit impairment. As a result of this change, and in recognition of recent company performance and current market conditions, we decreased the fair value of our investment in USC to $145,618 as of June 30, 2015, a discount of $12,620 from its amortized cost, compared to being valued at cost at June 30, 2014.

During the year ended June 30, 2015, we provided $1,381 and $107 of debt and equity financing, respectively, to American Property REIT Corp. (“APRC”) for the acquisition of real estate properties and to fund capital expenditures for existing properties. During the year ended June 30, 2015, APRC transferred its investments in certain properties to National Property REIT Corp. (“NPRC”). As a result, our investments in APRC related to these properties also transferred to NPRC. The investments transferred consisted of $12,985 of equity and $95,576 of debt. There was no gain or loss realized on these transactions. In addition, during the year ended June 30, 2015, we received $8 as a return of capital on the equity investment in APRC. As of June 30, 2015, our investment in APRC had an amortized cost of $100,192 and a fair value of $118,256.

As of June 30, 2015, APRC’s real estate portfolio was comprised of twelve multi-family properties and one commercial property. The following table shows the location, acquisition date, purchase price, and mortgage outstanding due to other parties for each of the properties held by APRC as of June 30, 2015.

No.	Property Name	City	Acquisition Date	Purchase Price	Mortgage Outstanding
1	1557 Terrell Mill Road, LLC	Marietta, GA	12/28/2012	$23,500	$ 15,164
2	Lofton Place, LLC	Tampa, FL	4/30/2013	26,000	16,965
3	Vista Palma Sola, LLC	Bradenton, FL	4/30/2013	27,000	17,550
4	Arlington Park Marietta, LLC	Marietta, GA	5/8/2013	14,850	9,650
5	Cordova Regency, LLC	Pensacola, FL	11/15/2013	13,750	9,026
6	Crestview at Oakleigh, LLC	Pensacola, FL	11/15/2013	17,500	11,488
7	Inverness Lakes, LLC	Mobile, AL	11/15/2013	29,600	19,400
8	Kings Mill Pensacola, LLC	Pensacola, FL	11/15/2013	20,750	13,622
9	Plantations at Pine Lake, LLC	Tallahassee, FL	11/15/2013	18,000	11,817
10	Verandas at Rock Ridge, LLC	Birmingham, AL	11/15/2013	15,600	10,205
11	Plantations at Hillcrest, LLC	Mobile, AL	1/17/2014	6,930	4,972
12	Crestview at Cordova, LLC	Pensacola, FL	1/17/2014	8,500	4,950
13	Taco Bell, OK	Yukon, OK	6/4/2014	1,719	—
				$223,699	$ 144,809

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During the year ended June 30, 2015, we provided $171,850 and $52,350 of debt and equity financing, respectively, to NPRC to enable certain of its wholly-owned subsidiaries to invest in online consumer loans. In addition, during the year ended June 30, 2015, we received partial repayments of $32,883 of the loans previously outstanding and $5,577 as a return of capital on the equity investment in NPRC.

The online consumer loan investments held by certain of NPRC's wholly-owned subsidiaries are unsecured obligations of individual borrowers that are issued in amounts ranging from $1 to $35, with fixed interest rates and fixed terms of either 36 or 60 months. As of June 30, 2015, the investment in online consumer loans by certain of NPRC's wholly-owned subsidiaries had a fair value of $366,014. The average outstanding individual loan balance is approximately $9 and the loans mature on dates ranging from October 31, 2016 to June 29, 2020. Fixed interest rates range from 5.3% to 29.0% with a weighted-average current interest rate of 19.6%.

During the year ended June 30, 2015, we provided $12,046 and $2,077 of debt and equity financing, respectively, to NPRC for the acquisition of real estate properties and to fund capital expenditures for existing properties. During the year ended June 30, 2015, APRC and United Property REIT Corp. ("UPRC") transferred their investments in certain properties to NPRC. As a result, our investments in APRC and UPRC related to these properties also transferred to NPRC. The investments transferred consisted of $14,266 of equity and $105,020 of debt. There was no gain or loss realized on these transactions. As of June 30, 2015, our investment in NPRC had an amortized cost of $449,660 and a fair value of $471,889.

As of June 30, 2015, NPRC's real estate portfolio was comprised of eleven multi-family properties and thirteen commercial properties. The following table shows the location, acquisition date, purchase price, and mortgage outstanding due to other parties for each of the properties held by NPRC as of June 30, 2015.

No.	Property Name	City	Acquisition Date	Purchase Price	Mortgage Outstanding
1	146 Forest Parkway, LLC	Forest Park, GA	10/24/2012	$7,400	$ —
2	5100 Live Oaks Blvd, LLC	Tampa, FL	1/17/2013	63,400	39,600
3	NPRC Carroll Resort, LLC	Pembroke Pines, FL	6/24/2013	225,000	157,500
4	APH Carroll 41, LLC	Marietta, GA	11/1/2013	30,600	22,097
5	Matthews Reserve II, LLC	Matthews, NC	11/19/2013	22,063	17,571
6	City West Apartments II, LLC	Orlando, FL	11/19/2013	23,562	18,533
7	Vinings Corner II, LLC	Smyrna, GA	11/19/2013	35,691	26,640
8	Uptown Park Apartments II, LLC	Altamonte Springs, FL	11/19/2013	36,590	27,471
9	Mission Gate II, LLC	Plano, TX	11/19/2013	47,621	36,148
10	St. Marin Apartments II, LLC	Coppell, TX	11/19/2013	73,078	53,863
11	APH Carroll Bartram Park, LLC	Jacksonville, FL	12/31/2013	38,000	28,500
12	APH Carroll Atlantic Beach, LLC	Atlantic Beach, FL	1/31/2014	13,025	8,916
13	23 Mile Road Self Storage, LLC	Chesterfield, MI	8/19/2014	5,804	4,350
14	36th Street Self Storage, LLC	Wyoming, MI	8/19/2014	4,800	3,600
15	Ball Avenue Self Storage, LLC	Grand Rapids, MI	8/19/2014	7,281	5,460
16	Ford Road Self Storage, LLC	Westland, MI	8/29/2014	4,642	3,480
17	Ann Arbor Kalamazoo Self Storage, LLC	Ann Arbor, MI	8/29/2014	4,458	3,345
18	Ann Arbor Kalamazoo Self Storage, LLC	Scio, MI	8/29/2014	8,927	6,695
19	Ann Arbor Kalamazoo Self Storage, LLC	Kalamazoo, MI	8/29/2014	2,363	1,775
20	Jolly Road Self Storage, LLC	Okemos, MI	1/16/2015	7,492	5,620
21	Eaton Rapids Road Self Storage, LLC	Lansing West, MI	1/16/2015	1,741	1,305
22	Haggerty Road Self Storage, LLC	Novi, MI	1/16/2015	6,700	5,025
23	Waldon Road Self Storage, LLC	Lake Orion, MI	1/16/2015	6,965	5,225
24	Tyler Road Self Storage, LLC	Ypsilanti, MI	1/16/2015	3,507	2,630
				$680,710	$ 485,349

During the year ended June 30, 2015, we provided $53,022 and $9,100 of debt and equity financing, respectively, to UPRC for the acquisition of certain properties and to fund capital expenditures for existing properties. During the year ended June 30, 2015, UPRC transferred its investments in certain properties to NPRC. As a result, our investments in UPRC related to these properties also transferred to NPRC. The investments transferred consisted of $1,281 of equity and $9,444 of debt. There was no gain or loss realized on the transaction. As of June 30, 2015, our investment in UPRC had an amortized cost of $75,628 and a fair value of $84,685.

As of June 30, 2015, UPRC's real estate portfolio was comprised of fifteen multi-families properties and one commercial property. The following table shows the location, acquisition date, purchase price, and mortgage outstanding due to other parties for each of the properties held by UPRC as of June 30, 2015.

No.	Property Name	City	Acquisition Date	Purchase Price	Mortgage Outstanding
1	Atlanta Eastwood Village LLC	Stockbridge, GA	12/12/2013	$25,957	$ 19,785
2	Atlanta Monterey Village LLC	Jonesboro, GA	12/12/2013	11,501	9,193
3	Atlanta Hidden Creek LLC	Morrow, GA	12/12/2013	5,098	3,619
4	Atlanta Meadow Springs LLC	College Park, GA	12/12/2013	13,116	10,180
5	Atlanta Meadow View LLC	College Park, GA	12/12/2013	14,354	11,141
6	Atlanta Peachtree Landing LLC	Fairburn, GA	12/12/2013	17,224	13,575
7	Taco Bell, MO	Marshall, MO	6/4/2014	1,405	—
8	Canterbury Green Apartments Holdings LLC	Fort Wayne, IN	9/29/2014	85,500	65,825
9	Abbie Lakes OH Partners, LLC	Canal Winchester, OH	9/30/2014	12,600	10,440
10	Kengary Way OH Partners, LLC	Reynoldsburg, OH	9/30/2014	11,500	11,000
11	Lakeview Trail OH Partners, LLC	Canal Winchester, OH	9/30/2014	26,500	20,142
12	Lakepoint OH Partners, LLC	Pickerington, OH	9/30/2014	11,000	10,080
13	Sunbury OH Partners, LLC	Columbus, OH	9/30/2014	13,000	10,480
14	Heatherbridge OH Partners, LLC	Blacklick, OH	9/30/2014	18,416	15,480
15	Jefferson Chase OH Partners, LLC	Blacklick, OH	9/30/2014	13,551	12,240
16	Goldenstrand OH Partners, LLC	Hilliard, OH	10/29/2014	7,810	8,040
				$288,532	$ 231,220

On January 4, 2012, Energy Solutions Holdings Inc. ("Energy Solutions") sold its gas gathering and processing assets held in Gas Solutions II Ltd. ("Gas Solutions") for a potential sale price of $199,805, adjusted for the final working capital settlement, including a potential earn-out of $28,000 that may be paid based on the future performance of Gas Solutions. After expenses, including structuring fees of $9,966 paid to us, and $3,152 of third-party expenses, Gas Solutions LP LLC and Gas Solutions GP LLC, subsidiaries of Gas Solutions, received $157,100 and $1,587 in cash, respectively, and subsequently distributed these amounts, $158,687 in total, to Energy Solutions. On June 4, 2014, Gas Solutions GP LLC and Gas Solutions LP LLC merged with and into Freedom Marine Solutions, LLC (f/k/a Freedom Marine Services Holdings, LLC) ("Freedom Marine"), another subsidiary of Energy Solutions, with Freedom Marine as the surviving entity. On December 29, 2014, Freedom Marine reached a settlement for and received $5,174, net of third-party obligations, related to the contingent earn-out from the sale of Gas Solutions in January 2012 which was retained by Freedom Marine. This is a final settlement and no further payments are expected from the sale.

On August 6, 2013, we received a distribution of $4,065 related to our investment in NRG Manufacturing, Inc. ("NRG") for which we realized a gain of $3,252. This was a partial release of the amount held in escrow. On February 17, 2015, we received a distribution of $7,140 related to our investment in NRG for which we realized a gain of $4,647. This was a full release of the amount held in escrow. The $7,140 distribution received from NRG included $1,739 as reimbursement for legal, tax and portfolio level accounting services provided directly to NRG for which Prospect received payment on behalf of Prospect Administration (no direct income was recognized by Prospect, but Prospect was given credit for these payments as a reduction of the administrative services costs payable by Prospect to Prospect Administration).

On October 31, 2013, we sold $18,755 of the National Bankruptcy Services, LLC loan receivable. The loan receivable was sold at a discount and we realized a loss of $7,853.

During the year ended June 30, 2014, Energy Solutions repaid $8,500 of our subordinated secured debt to us. In addition to the repayment of principal, we received $4,812 of make-whole fees for early repayment of the outstanding loan receivables, which was recorded as additional interest income during the year ended June 30, 2014.

On November 25, 2013, we provided $13,000 in senior secured debt financing for the recapitalization of our investment in Freedom Marine. The subordinated secured loan to Jettco Marine Services, LLC, a subsidiary of Freedom Marine, was replaced with a senior secured note to Vessel Company II, LLC (f/k/a Vessel Holdings II, LLC) ("Vessel II"), a new subsidiary of Freedom Marine. On December 3, 2013, we made a $16,000 senior secured investment in Vessel Company III, LLC (f/k/a Vessel Holdings III, LLC), another new subsidiary of Freedom Marine. Overall the restructuring of our investment in Freedom Marine provided approximately $16,000 net senior secured debt financing to support the acquisition of two new vessels. We received $2,480 of structuring fees from Energy Solutions related to the Freedom Marine restructuring which was recognized as other income during the year ended June 30, 2014.

During the year ended June 30, 2014, we received an $8,000 fee from First Tower Holdings of Delaware LLC ("First Tower Delaware") related to the renegotiation and expansion of First Tower's revolver in December 2013 which was recorded as other income and we provided an additional $8,500 and $1,500 of senior secured first-lien and common equity financing, respectively, to First Tower Delaware.

During the year ended June 30, 2014, we provided an additional $7,600 of subordinated secured financing to AMU Holdings Inc. ("AMU"). During the year ended June 30, 2014, we received distributions of $12,000 from AMU which were recorded as dividend income.

On March 31, 2014, we invested $246,250 in cash and 2,306,294 unregistered shares of our common stock to support the recapitalization of Harbortouch Payments, LLC (f/k/a United Bank Card, Inc. (d/b/a Harbortouch)), a provider of transaction processing services and point-of-sale equipment used by merchants across the United States. We invested $24,898 of equity and $123,000 of debt in Harbortouch Holdings of Delaware Inc., the newly-formed holding company, and $130,796 of debt in Harbortouch Payments, LLC, the operating company (collectively, "Harbortouch"). Through the recapitalization, we acquired a controlling interest in Harbortouch Holdings of Delaware Inc. After the recapitalization, we received repayment of the $23,894 loan previously outstanding. We received structuring fees of $7,536 related to our investment in Harbortouch which were recognized as other income during the year ended June 30, 2014.

On March 31, 2014, we provided $78,521 of debt and $14,107 of equity financing to Echelon Aviation LLC ("Echelon"), a newly established portfolio company which provides liquidity alternatives on aviation assets. In connection with our investment, we received a structuring fee of $2,771 from Echelon which was recognized as other income during the year ended June 30, 2014.

On August 1, 2014, we sold our investments in Airmall Inc. ("Airmall") for net proceeds of $51,379 and realized a loss of $3,473 on the sale. In addition, there is $6,000 being held in escrow, of which 98% is due to Prospect, which will be recognized as an additional realized loss if it is not received. Included in the net proceeds were $3,000 of structuring fees from Airmall related to the sale of the operating company which was recognized as other income during the year ended June 30, 2015. On October 22, 2014, we received a tax refund of $665 related to our investment in Airmall for which we realized a gain of the same amount.

On August 20, 2014, we sold the assets of Borga, Inc., a wholly-owned subsidiary of STI Holding, Inc. ("STI"), for net proceeds of $382 and realized a loss of $2,589 on the sale. On December 29, 2014, Borga was dissolved.

On August 25, 2014, we sold Boxercraft Incorporated, a wholly-owned subsidiary of BXC Company, Inc. ("BXC"), for net proceeds of $750 and realized a net loss of $16,949 on the sale.

On September 30, 2014, we made a $26,431 follow-on investment in Harbortouch to support an acquisition. As part of the transaction, we received $529 of structuring fee income and $50 of amendment fee income from Harbortouch which was recognized as other income.

During the three months ended September 30, 2014, we determined that the impairment of Appalachian Energy LLC was other-than-temporary and recorded a realized loss of $2,050, reducing the amortized cost to zero.

On October 3, 2014, we sold our $35,000 investment in Babson CLO Ltd. 2011-I and realized a loss of $6,410 on the sale.

On October 10, 2014, ARRM Services, Inc. ("ARRM") sold Ajax Rolled Ring & Machine, LLC ("Ajax") to a third party and repaid the $19,337 loan receivable to us and we recorded a realized loss of $23,560 related to the sale. Concurrent with the sale, our ownership increased to 100% of the outstanding equity in SB Forging (see Note 1). As such, we began consolidating SB Forging on October 11, 2014. In addition, there is $3,000 being held in escrow of which $802

was received on May 6, 2015 for which we realized a gain of the same amount. The remainder will be recognized as additional gain if and when received. We received $2,000 of structuring fees from Ajax related to the sale of the operating company which was recognized as other income during the year ended June 30, 2015.
On October 20, 2014, we sold our $22,000 investment in Galaxy XII CLO, Ltd. and realized a loss of $2,435 on the sale.

On November 21, 2014, Coalbed, LLC (“Coalbed”) merged with and into Wolf Energy, LLC (“Wolf Energy”), with Wolf Energy as the surviving entity. During the three months ended December 31, 2014, we determined that the impairment of the Coalbed debt assumed by Wolf Energy was other-than-temporary and recorded a realized loss of $5,991, reducing the amortized cost to zero.

On December 4, 2014, we sold our $29,075 investment in Babson CLO Ltd. 2012-I and realized a loss of $3,767 on the sale.

On December 4, 2014, we sold our $27,850 investment in Babson CLO Ltd. 2012-II and realized a loss of $2,949 on the sale.

During the three months ended December 31, 2014, Manx Energy, Inc. (“Manx”) was dissolved and we recorded a realized loss of $50, reducing the amortized cost to zero.

During the three months ended December 31, 2014, we determined that the impairments of Change Clean Energy Company, LLC and Yatesville Coal Company, LLC (“Yatesville”) were other-than-temporary and recorded a realized loss of $1,449, reducing the amortized cost to zero.

During the three months ended December 31, 2014, we determined that the impairment of New Century Transportation, Inc. (“NCT”) was other-than-temporary and recorded a realized loss of $42,064, reducing the amortized cost to $980.

During the three months ended December 31, 2014, we determined that the impairment of Stryker Energy, LLC (“Stryker”) was other-than-temporary and recorded a realized loss of $32,711, reducing the amortized cost to zero.

During the three months ended December 31, 2014, we determined that the impairment of Wind River Resources Corporation (“Wind River”) was other-than-temporary and recorded a realized loss of $11,650, reducing the amortized cost to $3,000.

On June 5, 2015, we sold our equity investment in Vets Securing America, Inc. (“VSA”) and realized a net loss of $975 on the sale. In connection with the sale, VSA was released as a borrower on the secured promissory notes, leaving The Healing Staff, Inc. (“THS”) as the sole borrower. During the year ended June 30, 2015, THS ceased operations and we recorded a realized loss of $2,956, reducing the amortized cost to zero.

On June 9, 2015, we provided additional debt and equity financing to support the recapitalization of Edmentum. As part of the recapitalization, we exchanged 100% of the $50,000 second lien term loan previously outstanding for $26,365 of junior PIK notes and 370,964.14 Class A common units representing 37.1% equity ownership in Edmentum Ultimate Holdings, LLC. In addition, we invested $5,875 in senior PIK notes and committed $7,834 as part of a second lien revolving credit facility, of which $4,896 was funded at closing. On June 9, 2015, we determined that the impairment of Edmentum was other-than-temporary and recorded a realized loss of $22,116 for the amount that the amortized cost exceeded the fair value, reducing the amortized cost to $37,216.

During the year ended June 30, 2014, we recognized $400 of interest income due to purchase discount accretion for the assets acquired from Patriot. As of December 31, 2013, the purchase discount for the assets acquired from Patriot had been fully accreted. As such, no such income was recognized during the year ended June 30, 2015.

As of June 30, 2015, $4,413,161 of our loans, at fair value, bear interest at floating rates and $4,380,763 of those loans have LIBOR floors ranging from 0.5% to 5.5%. As of June 30, 2014, $4,212,376 of our loans, at fair value, bore interest at floating rates and $4,179,177 of those loans had LIBOR floors ranging from 1.25% to 6.00%.

At June 30, 2015, four loan investments were on non-accrual status: Gulf Coast, NCT, Wind River, and Wolf Energy. At June 30, 2014, nine loan investments were on non-accrual status: BXC, THS, Manx, NCT, STI, Stryker, Wind River, Wolf Energy Holdings Inc., and Yatesville. Principal balances of these loans amounted to $62,143 and $163,408 as of June 30, 2015 and June 30, 2014, respectively. The fair value of these loans amounted to $6,918 and $5,937 as of June 30, 2015 and June 30, 2014, respectively. The fair values of these investments represent approximately 0.1% and 0.1% of our total assets as of June 30, 2015 and June 30, 2014, respectively. For the years ended June 30, 2015, 2014 and 2013, the income foregone as a result of not accruing interest on non-accrual debt investments amounted to $22,927, $24,040 and $25,965, respectively.

Undrawn committed revolvers and delayed draw term loans to our portfolio companies incur commitment and unused fees ranging from 0.00% to 2.00%. As of June 30, 2015 and June 30, 2014, we had $88,288 and $72,118, respectively, of undrawn revolver and delayed draw term loan commitments to our portfolio companies.

During the year ended June 30, 2015, we sold $132,909 of the outstanding principal balance of the senior secured Term Loan A investments in certain portfolio companies. There was no gain or loss realized on the sale. We serve as an agent for these loans and collect a servicing fee from the counterparties on behalf of the Investment Adviser. We receive a credit for these payments as a reduction of base management fee payable by us to the Investment Adviser. See Note 13 for further discussion.

Unconsolidated Significant Subsidiaries

Our investments are generally in small and mid-sized companies in a variety of industries. In accordance with Rules 3-09 and 4-08(g) of Regulation S-X, we must determine which of our unconsolidated controlled portfolio companies are considered “significant subsidiaries”, if any. In evaluating these investments, there are three tests utilized to determine if any of our controlled investments are considered significant subsidiaries: the investment test, the asset test and the income test. Rule 3-09 of Regulation S-X, as interpreted by the SEC, requires separate audited financial statements of an unconsolidated majority-owned subsidiary in an annual report if any of the three tests exceed 20%. Rule 4-08(g) of Regulation S-X requires summarized financial information in an annual report if any of the three tests exceeds 10% and summarized financial information in a quarterly report if any of the three tests exceeds 20%.

As of June 30, 2015, we had no single investment that represented greater than 10% of our total investment portfolio at fair value. As of June 30, 2015, we had one investment whose assets represented greater than 10% but less than 20% of our total assets. Income, consisting of interest, dividends, fees, other investment income and gains or losses, which can fluctuate upon repayment or sale of an investment or the marking to fair value of an investment in any given year can be highly concentrated among several investments. After performing the income analysis for the year ended June 30, 2015, we determined that one of our controlled investments individually generated more than 10% but less than 20% of our income, primarily due to the unrealized appreciation that was recognized on the investment during the year ended June 30, 2015. As such, the following unconsolidated majority-owned portfolio company was considered a significant subsidiary at the 10% level as of June 30, 2015: National Property REIT Corp.

The following tables show summarized financial information for National Property REIT Corp. and its subsidiaries, which met the 10% asset test and the 10% income test:

	June 30, 2015	June 30, 2014
Balance Sheet Data		
Cash and cash equivalents	$43,722	$17,204
Real estate, net	639,012	312,896
Unsecured consumer loans, net	366,014	45,597
Other assets	51,383	8,185
Mortgages payable	484,771	240,176
Revolving credit facilities	208,296	27,600
Notes payable, due to Prospect or Affiliate	365,214	105,309
Other liabilities	21,736	5,173
Total equity	20,114	5,624

	Twelve Months Ended June 30, 2015	From Inception (December 30, 2013) to June 30, 2014
Summary of Operations		
Total revenue	$120,576	$20,669
Operating expenses	115,206	20,507
Operating income	5,370	162
Depreciation and amortization	23,960	11,978
Fair value adjustment	7,005	578
Net loss	$(25,595)	$(12,394)

As of June 30, 2015, we had no single investment that represented greater than 20% of our total investment portfolio at fair value. As of June 30, 2015, we had no single investment whose assets represented greater than 20% of our total assets. After performing the income analysis, as discussed earlier, for the year ended June 30, 2015, we determined that two of our controlled investments individually generated more than 20% of our income, primarily due to the unrealized appreciation that was recognized on the investments during the year ended June 30, 2015. As such, the

following unconsolidated majority-owned portfolio companies were considered significant subsidiaries at the 20% level as of June 30, 2015: First Tower Finance Company LLC and Harbortouch Payments, LLC.

The following tables show summarized financial information for First Tower Finance Company LLC and its subsidiaries:

	June 30, 2015	June 30, 2014
Balance Sheet Data		
Cash and cash equivalents	$65,614	$60,368
Finance receivables, net	400,451	385,875
Intangibles, including goodwill	121,822	137,696
Other assets	17,373	14,056
Notes payable	334,637	313,563
Notes payable, due to Prospect or Affiliate	251,578	251,246
Other liabilities	47,493	46,276
Total equity	(28,448)	(13,090)

	Twelve Months Ended June 30,		
	2015	2014	2013
Summary of Operations			
Total revenue	$207,128	$201,724	$186,037
Total expenses	219,143	162,941	144,368
Net (loss) income	$(12,015)	$38,783	$41,669

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The following tables show summarized financial information for Harbortouch Payments, LLC:

	June 30, 2015	June 30, 2014
Balance Sheet Data		
Cash and cash equivalents	$ 168	$ 2,083
Receivables	28,721	24,530
Intangibles, including goodwill	351,396	400,453
Other assets	28,686	15,106
Notes payable	25,132	24,329
Notes payable, due to Prospect or Affiliate	296,734	268,022
Other liabilities	37,235	42,734
Total equity	49,870	107,087

	Twelve Months Ended June 30, 2015	From Inception (March 31, 2014) to June 30, 2014
Summary of Operations		
Total revenue	$ 280,606	$ 68,759
Total expenses	329,469	82,673
Net loss	$ (48,863)	$ (13,914)

As the SEC has not released details on the mechanics of how the calculations related to Rules 3-09 and 4-08(g) of Regulation S-X are to be completed, there is diversity in practice for the calculations. Based on our interpretation of Rule 3-09 of Regulation S-X and related calculations, we have included the separate financial statements of First Tower Finance Company LLC and Harbortouch Payments, LLC as exhibits to this report. We expect that the SEC will clarify the calculation methods in the near future.

Note 4. Revolving Credit Facility

On March 27, 2012, we closed on an extended and expanded credit facility with a syndicate of lenders through PCF (the “2012 Facility”). The lenders had extended commitments of $857,500 under the 2012 Facility as of June 30, 2014, which was increased to $877,500 in July 2014. The 2012 Facility included an accordion feature which allowed commitments to be increased up to $1,000,000 in the aggregate. Interest on borrowings under the 2012 Facility was one-month LIBOR plus 275 basis points with no minimum LIBOR floor. Additionally, the lenders charged a fee on the unused portion of the 2012 Facility equal to either 50 basis points if at least half of the credit facility is drawn or 100 basis points otherwise.

On August 29, 2014, we renegotiated the 2012 Facility and closed an expanded five and a half year revolving credit facility (the “2014 Facility” and collectively with the 2012 Facility, the “Revolving Credit Facility”). The lenders have extended commitments of $885,000 under the 2014 Facility as of June 30, 2015. The 2014 Facility includes an accordion feature which allows commitments to be increased up to $1,500,000 in the aggregate. The revolving period of the 2014 Facility extends through March 2019, with an additional one year amortization period (with distributions allowed) after the completion of the revolving period. During such one year amortization period, all principal payments on the pledged assets will be applied to reduce the balance. At the end of the one year amortization period, the remaining balance will become due, if required by the lenders.

The 2014 Facility contains restrictions pertaining to the geographic and industry concentrations of funded loans, maximum size of funded loans, interest rate payment frequency of funded loans, maturity dates of funded loans and minimum equity requirements. The 2014 Facility also contains certain requirements relating to portfolio performance, including required minimum portfolio yield and limitations on delinquencies and charge-offs, violation of which could result in the early termination of the 2014 Facility. The 2014 Facility also requires the maintenance of a minimum liquidity requirement. As of June 30, 2015, we were in compliance with the applicable covenants.

Interest on borrowings under the 2014 Facility is one-month LIBOR plus 225 basis points with no minimum LIBOR floor. Additionally, the lenders charge a fee on the unused portion of the 2014 Facility equal to either 50 basis points if at least 35% of the credit facility is drawn or 100 basis points otherwise. The 2014 Facility requires us to pledge assets as collateral in order to borrow under the credit facility.

As of June 30, 2015 and June 30, 2014, we had $721,800 and $780,620, respectively, available to us for borrowing under the Revolving Credit Facility, of which the amount outstanding was $368,700 and $92,000, respectively. As additional eligible investments are transferred to PCF and pledged under the Revolving Credit Facility, PCF will generate additional availability up to the current commitment amount of $885,000. As of June 30, 2015, the investments, including money market funds, used as collateral for the Revolving Credit Facility had an aggregate fair value of $1,539,763, which represents 22.9% of our total investments and money market funds. These assets are held and owned by PCF, a bankruptcy remote special purpose entity, and as such, these investments are not available to our general creditors. The release of any assets from PCF requires the approval of the facility agent.
In connection with the origination and amendments of the Revolving Credit Facility, we incurred $8,866 of new fees and $3,539 of fees carried over for continuing participants from the previous facility, which are being amortized over the term of the facility in accordance with ASC 470-50, of which $10,280 remains to be amortized and is included within deferred financing costs on the Consolidated Statement of Assets and Liabilities as of June 30, 2015. In accordance with ASC 470-50, we expensed $332 of fees relating to credit providers in the 2012 Facility who did not commit to the 2014 Facility.

During the years ended June 30, 2015, 2014 and 2013, we recorded $14,424, $12,216 and $9,082, respectively, of interest costs, unused fees and amortization of financing costs on the Revolving Credit Facility as interest expense.
Note 5. Convertible Notes
On December 21, 2010, we issued $150,000 aggregate principal amount of convertible notes that mature on December 15, 2015 (the “2015 Notes”), unless previously converted or repurchased in accordance with their terms. The 2015 Notes bear interest at a rate of 6.25% per year, payable semi-annually on June 15 and December 15 of each year, beginning June 15, 2011. Total proceeds from the issuance of the 2015 Notes, net of underwriting discounts and offering costs, were $145,200.
On February 18, 2011, we issued $172,500 aggregate principal amount of convertible notes that mature on August 15, 2016 (the “2016 Notes”), unless previously converted or repurchased in accordance with their terms. The 2016 Notes bear interest at a rate of 5.50% per year, payable semi-annually on February 15 and August 15 of each year, beginning August 15, 2011. Total proceeds from the issuance of the 2016 Notes, net of underwriting discounts and offering costs, were $167,325. Between January 30, 2012 and February 2, 2012, we repurchased $5,000 aggregate principal amount of the 2016 Notes at a price of 97.5, including commissions. The transactions resulted in our recognizing $10 of loss in the year ended June 30, 2012.
On April 16, 2012, we issued $130,000 aggregate principal amount of convertible notes that mature on October 15, 2017 (the “2017 Notes”), unless previously converted or repurchased in accordance with their terms. The 2017 Notes bear interest at a rate of 5.375% per year, payable semi-annually on April 15 and October 15 of each year, beginning October 15, 2012. Total proceeds from the issuance of the 2017 Notes, net of underwriting discounts and offering costs, were $126,035.
On August 14, 2012, we issued $200,000 aggregate principal amount of convertible notes that mature on March 15, 2018 (the “2018 Notes”), unless previously converted or repurchased in accordance with their terms. The 2018 Notes bear interest at a rate of 5.75% per year, payable semi-annually on March 15 and September 15 of each year, beginning March 15, 2013. Total proceeds from the issuance of the 2018 Notes, net of underwriting discounts and offering costs, were $193,600.
On December 21, 2012, we issued $200,000 aggregate principal amount of convertible notes that mature on January 15, 2019 (the “2019 Notes”), unless previously converted or repurchased in accordance with their terms. The 2019 Notes bear interest at a rate of 5.875% per year, payable semi-annually on January 15 and July 15 of each year, beginning July 15, 2013. Total proceeds from the issuance of the 2019 Notes, net of underwriting discounts and offering costs, were $193,600.
On April 11, 2014, we issued $400,000 aggregate principal amount of convertible notes that mature on April 15, 2020 (the “2020 Notes”), unless previously converted or repurchased in accordance with their terms. The 2020 Notes bear interest at a rate of 4.75% per year, payable semi-annually on April 15 and October 15 each year, beginning October 15, 2014. Total proceeds from the issuance of the 2020 Notes, net of underwriting discounts and offering costs, were $387,500. On January 30, 2015, we repurchased $8,000 aggregate principal amount of the 2020 Notes at a price of

93.0, including commissions. As a result of this transaction, we recorded a gain in the amount of the difference between the reacquisition price and the net carrying amount of the notes, net of the proportionate amount of unamortized debt issuance costs. The net gain on the extinguishment of the 2020 Notes in the year ended June 30, 2015 was $332.

Certain key terms related to the convertible features for the 2015 Notes, the 2016 Notes, the 2017 Notes, the 2018 Notes, the 2019 Notes and the 2020 Notes (collectively, the “Convertible Notes”) are listed below.

	2015 Notes	2016 Notes	2017 Notes	2018 Notes	2019 Notes	2020 Notes
Initial conversion rate(1)	88.0902	78.3699	85.8442	82.3451	79.7766	80.6647
Initial conversion price	$11.35	$12.76	$11.65	$12.14	$12.54	$12.40
Conversion rate at June 30, 2015(1)(2)	89.9752	80.2196	87.7516	83.6661	79.8248	80.6670
Conversion price at June 30, 2015(2)(3)	$11.11	$12.47	$11.40	$11.95	$12.53	$12.40
Last conversion price calculation date	12/21/2014	2/18/2015	4/16/2015	8/14/2014	12/21/2014	4/11/2015
Dividend threshold amount (per share)(4)	$0.101125	$0.101150	$0.101500	$0.101600	$0.110025	$0.110525

(1) Conversion rates denominated in shares of common stock per $1 principal amount of the Convertible Notes converted.

(2) Represents conversion rate and conversion price, as applicable, taking into account certain de minimis adjustments that will be made on the conversion date.

(3) The conversion price in effect at June 30, 2015 was calculated on the last anniversary of the issuance and will be adjusted again on the next anniversary, unless the exercise price shall have changed by more than 1% before the anniversary.

(4) The conversion rate is increased if monthly cash dividends paid to common shares exceed the monthly dividend threshold amount, subject to adjustment.

In no event will the total number of shares of common stock issuable upon conversion exceed 96.8992 per $1 principal amount of the 2015 Notes (the “conversion rate cap”), except that, to the extent we receive written guidance or a no-action letter from the staff of the Securities and Exchange Commission (the “Guidance”) permitting us to adjust the conversion rate in certain instances without regard to the conversion rate cap and to make the 2015 Notes convertible into certain reference property in accordance with certain reclassifications, business combinations, asset sales and corporate events by us without regard to the conversion rate cap, we will make such adjustments without regard to the conversion rate cap and will also, to the extent that we make any such adjustment without regard to the conversion rate cap pursuant to the Guidance, adjust the conversion rate cap accordingly. We will use our commercially reasonable efforts to obtain such Guidance as promptly as practicable.

Prior to obtaining the Guidance, we will not engage in certain transactions that would result in an adjustment to the conversion rate increasing the conversion rate beyond what it would have been in the absence of such transaction unless we have engaged in a reverse stock split or share combination transaction such that in our reasonable best estimation, the conversion rate following the adjustment for such transaction will not be any closer to the conversion rate cap than it would have been in the absence of such transaction.

Upon conversion, unless a holder converts after a record date for an interest payment but prior to the corresponding interest payment date, the holder will receive a separate cash payment with respect to the notes surrendered for conversion representing accrued and unpaid interest to, but not including, the conversion date. Any such payment will be made on the settlement date applicable to the relevant conversion on the Convertible Notes.

No holder of Convertible Notes will be entitled to receive shares of our common stock upon conversion to the extent (but only to the extent) that such receipt would cause such converting holder to become, directly or indirectly, a beneficial owner (within the meaning of Section 13(d) of the Securities Exchange Act of 1934 and the rules and regulations promulgated thereunder) of more than 5.0% of the shares of our common stock outstanding at such time. The 5.0% limitation shall no longer apply following the effective date of any fundamental change. We will not issue any shares in connection with the conversion or redemption of the Convertible Notes which would equal or exceed 20% of the shares outstanding at the time of the transaction in accordance with NASDAQ rules.

Subject to certain exceptions, holders may require us to repurchase, for cash, all or part of their Convertible Notes upon a fundamental change at a price equal to 100% of the principal amount of the Convertible Notes being repurchased plus any accrued and unpaid interest up to, but excluding, the fundamental change repurchase date. In addition, upon a fundamental change that constitutes a non-stock change of control we will also pay holders an amount in cash equal to the present value of all remaining interest payments (without duplication of the foregoing amounts) on such Convertible Notes through and including the maturity date.

In connection with the issuance of the Convertible Notes, we incurred $39,678 of fees which are being amortized over the terms of the notes, of which $21,274 remains to be amortized and is included within deferred financing costs on the Consolidated Statement of Assets and Liabilities as of June 30, 2015.

During the years ended June 30, 2015, 2014 and 2013, we recorded $74,365, $58,042 and $45,880, respectively, of interest costs and amortization of financing costs on the Convertible Notes as interest expense.

Note 6. Public Notes

On May 1, 2012, we issued $100,000 aggregate principal amount of unsecured notes that were scheduled to mature on November 15, 2022 (the “2022 Notes”). The 2022 Notes bore interest at a rate of 6.95% per year, payable quarterly on February 15, May 15, August 15 and November 15 of each year, beginning August 15, 2012. Total proceeds from the issuance of the 2022 Notes, net of underwriting discounts and offering costs, were $97,000. On May 15, 2015, we redeemed $100,000 aggregate principal amount of the 2022 Notes at par. As a result of this transaction, we recorded a loss in the amount of the difference between the reacquisition price and the net carrying amount of the notes, net of the proportionate amount of unamortized debt issuance costs. The net loss on the extinguishment of the 2022 Notes in the year ended June 30, 2015 was $2,600.

On March 15, 2013, we issued $250,000 aggregate principal amount of unsecured notes that mature on March 15, 2023 (the “2023 Notes”). The 2023 Notes bear interest at a rate of 5.875% per year, payable semi-annually on March 15 and September 15 of each year, beginning September 15, 2013. Total proceeds from the issuance of the 2023 Notes, net of underwriting discounts and offering costs, were $245,885.

On April 7, 2014, we issued $300,000 aggregate principal amount of unsecured notes that mature on July 15, 2019 (the “5.00% 2019 Notes”). Included in the issuance is $45,000 of Prospect Capital InterNotes® that were exchanged for the 5.00% 2019 Notes. The 5.00% 2019 Notes bear interest at a rate of 5.00% per year, payable semi-annually on January 15 and July 15 of each year, beginning July 15, 2014. Total proceeds from the issuance of the 5.00% 2019 Notes, net of underwriting discounts and offering costs, were $250,775.

The 2022 Notes, the 2023 Notes and the 5.00% 2019 Notes (collectively, the “Public Notes”) are direct unsecured obligations and rank equally with all of our unsecured indebtedness from time to time outstanding.

In connection with the issuance of the 2023 Notes and the 5.00% 2019 Notes, we incurred $8,036 of fees which are being amortized over the term of the notes, of which $6,604 remains to be amortized and is included within deferred financing costs on the Consolidated Statement of Assets and Liabilities as of June 30, 2015.

During the years ended June 30, 2015, 2014 and 2013, we recorded $37,063, $25,988 and $11,672, respectively, of interest costs and amortization of financing costs on the Public Notes as interest expense.

Note 7. Prospect Capital InterNotes®

On February 16, 2012, we entered into a selling agent agreement (the “Selling Agent Agreement”) with Incapital LLC, as purchasing agent for our issuance and sale from time to time of up to $500,000 of Prospect Capital InterNotes® (the “InterNotes® Offering”), which was increased to $1,500,000 in May 2014. Additional agents may be appointed by us from time to time in connection with the InterNotes® Offering and become parties to the Selling Agent Agreement.

These notes are direct unsecured obligations and rank equally with all of our unsecured indebtedness from time to time outstanding. Each series of notes will be issued by a separate trust. These notes bear interest at fixed interest rates and offer a variety of maturities no less than twelve months from the original date of issuance.

During the year ended June 30, 2015, we issued $125,696 aggregate principal amount of Prospect Capital InterNotes® for net proceeds of $123,641. These notes were issued with stated interest rates ranging from 3.375% to 5.10% with a weighted average interest rate of 4.65%. These notes mature between May 15, 2020 and June 15, 2022.

The following table summarizes the Prospect Capital InterNotes® issued during the year ended June 30, 2015.

Tenor at Origination (in years)	Principal Amount	Interest Rate Range	Weighted Average Interest Rate		Maturity Date Range
5.25	$7,126	4.625%	4.625	%	August 15, 2020 – September 15, 2020
5.5	106,364	4.25%–4.75%	4.63	%	May 15, 2020 – November 15, 2020
6	2,197	3.375%	3.375	%	April 15, 2021 – May 15, 2021
6.5	3,912	5.10%	5.10	%	December 15, 2021
7	6,097	5.10%	5.10	%	May 15, 2022 – June 15, 2022
	$125,696				

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During the year ended June 30, 2014, we issued $473,762 aggregate principal amount of Prospect Capital InterNotes® for net proceeds of $465,314. These notes were issued with stated interest rates ranging from 3.75% to 6.75% with a weighted average interest rate of 5.12%. These notes mature between October 15, 2016 and October 15, 2043. The following table summarizes the Prospect Capital InterNotes® issued during the year ended June 30, 2014.

Tenor at Origination (in years)	Principal Amount	Interest Rate Range	Weighted Average Interest Rate		Maturity Date Range
3	$5,710	4.00%	4.00	%	October 15, 2016
3.5	3,149	4.00%	4.00	%	April 15, 2017
4	45,751	3.75%–4.00%	3.92	%	November 15, 2017 – May 15, 2018
5	207,915	4.25%–5.00%	4.92	%	July 15, 2018 – May 15, 2019
5.5	53,820	4.75%–5.00%	4.86	%	February 15, 2019 – August 15, 2019
6.5	1,800	5.50%	5.50	%	February 15, 2020
7	62,409	5.25%–5.75%	5.44	%	July 15, 2020 – May 15, 2021
7.5	1,996	5.75%	5.75	%	February 15, 2021
10	23,850	5.75%–6.50%	5.91	%	January 15, 2024 – May 15, 2024
12	2,978	6.00%	6.00	%	November 15, 2025 – December 15, 2025
15	2,495	6.00%	6.00	%	August 15, 2028 – November 15, 2028
18	4,062	6.00%–6.25%	6.21	%	July 15, 2031 – August 15, 2031
20	2,791	6.00%	6.00	%	September 15, 2033 – October 15, 2033
25	34,886	6.25%–6.50%	6.39	%	August 15, 2038 – May 15, 2039
30	20,150	6.50%–6.75%	6.60	%	July 15, 2043 – October 15, 2043
	$473,762				

During the year ended June 30, 2015, we redeemed $76,931 aggregate principal amount of Prospect Capital InterNotes® at par with a weighted average interest rate of 6.06% in order to replace debt with higher interest rates with debt with lower rates. During the year ended June 30, 2015, we repaid $6,993 aggregate principal amount of Prospect Capital InterNotes® at par in accordance with the Survivor's Option, as defined in the InterNotes® Offering prospectus. As a result of these transactions, we recorded a loss in the amount of the difference between the reacquisition price and the net carrying amount of the notes, net of the proportionate amount of unamortized debt issuance costs. The net loss on the extinguishment of Prospect Capital InterNotes® in the year ended June 30, 2015 was $1,682. The following table summarizes the Prospect Capital InterNotes® outstanding as of June 30, 2015.

Tenor at Origination (in years)	Principal Amount	Interest Rate Range	Weighted Average Interest Rate		Maturity Date Range
3	$5,710	4.00%	4.00	%	October 15, 2016
3.5	3,109	4.00%	4.00	%	April 15, 2017
4	45,690	3.75%–4.00%	3.92	%	November 15, 2017 – May 15, 2018
5	207,719	4.25%–5.00%	4.92	%	July 15, 2018 – May 15, 2019
5.25	7,126	4.625%	4.63	%	August 15, 2020 – September 15, 2020
5.5	115,184	4.25%–5.00%	4.65	%	February 15, 2019 – November 15, 2020
6.0	2,197	3.375%	3.38	%	April 15, 2021 – May 15, 2021
6.5	5,712	5.10%–5.50%	5.23	%	February 15, 2020 – December 15, 2021
7	191,549	4.00%–5.85%	5.13	%	September 15, 2019 – June 15, 2022
7.5	1,996	5.75%	5.75	%	February 15, 2021
10	36,925	3.29%–7.00%	6.11	%	March 15, 2022 – May 15, 2024
12	2,978	6.00%	6.00	%	November 15, 2025 – December 15, 2025
15	17,385	5.00%–6.00%	5.14	%	May 15, 2028 – November 15, 2028
18	22,729	4.125%–6.25%	5.52	%	December 15, 2030 – August 15, 2031
20	4,530	5.75%–6.00%	5.89	%	November 15, 2032 – October 15, 2033

25	36,320	6.25%–6.50%	6.39	%	August 15, 2038 – May 15, 2039
30	120,583	5.50%–6.75%	6.23	%	November 15, 2042 – October 15, 2043
	$827,442				

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During the year ended June 30, 2014, we repaid $6,869 aggregate principal amount of Prospect Capital InterNotes® in accordance with the Survivor's Option, as defined in the InterNotes® Offering prospectus. In connection with the issuance of the 5.00% 2019 Notes, $45,000 of previously-issued Prospect Capital InterNotes® were exchanged for the 5.00% 2019 Notes. The following table summarizes the Prospect Capital InterNotes® outstanding as of June 30, 2014.

Tenor at Origination (in years)	Principal Amount	Interest Rate Range	Weighted Average Interest Rate	Maturity Date Range
3	$5,710	4.00%	4.00 %	October 15, 2016
3.5	3,149	4.00%	4.00 %	April 15, 2017
4	45,751	3.75%–4.00%	3.92 %	November 15, 2017 – May 15, 2018
5	207,915	4.25%–5.00%	4.92 %	July 15, 2018 – August 15, 2019
5.5	8,820	5.00%	4.86 %	February 15, 2019
6.5	1,800	5.50%	5.50 %	February 15, 2020
7	256,903	4.00%–6.55%	5.39 %	June 15, 2019 – May 15, 2021
7.5	1,996	5.75%	5.75 %	February 15, 2021
10	41,952	3.23%–7.00%	6.18 %	March 15, 2022 – May 15, 2024
12	2,978	6.00%	6.00 %	November 15, 2025 – December 15, 2025
15	17,465	5.00%–6.00%	5.14 %	May 15, 2028 – November 15, 2028
18	25,435	4.125%–6.25%	5.49 %	December 15, 2030 – August 15, 2031
20	5,847	5.625%–6.00%	5.85 %	November 15, 2032 – October 15, 2033
25	34,886	6.25%–6.50%	6.39 %	August 15, 2038 – May 15, 2039
30	125,063	5.50%–6.75%	6.22 %	November 15, 2042 – October 15, 2043
	$785,670			

In connection with the issuance of Prospect Capital InterNotes®, we incurred $20,168 of fees which are being amortized over the term of the notes, of which $16,262 remains to be amortized and is included within deferred financing costs on the Consolidated Statement of Assets and Liabilities as of June 30, 2015.

During the years ended June 30, 2015, 2014 and 2013, we recorded $44,808, $33,857 and $9,707, respectively, of interest costs and amortization of financing costs on the Prospect Capital InterNotes® as interest expense.

Note 8. Fair Value and Maturity of Debt Outstanding

The following table shows the maximum draw amounts and outstanding borrowings of our Revolving Credit Facility, Convertible Notes, Public Notes and Prospect Capital InterNotes® as of June 30, 2015 and June 30, 2014.

	June 30, 2015		June 30, 2014	
	Maximum Draw Amount	Amount Outstanding	Maximum Draw Amount	Amount Outstanding
Revolving Credit Facility	$885,000	$368,700	$857,500	$92,000
Convertible Notes	1,239,500	1,239,500	1,247,500	1,247,500
Public Notes	548,094	548,094	647,881	647,881
Prospect Capital InterNotes®	827,442	827,442	785,670	785,670
Total	$3,500,036	$2,983,736	$3,538,551	$2,773,051

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The following table shows the contractual maturities of our Revolving Credit Facility, Convertible Notes, Public Notes and Prospect Capital InterNotes® as of June 30, 2015.

	Payments Due by Period				
	Total	Less than 1 Year	1 – 3 Years	3 – 5 Years	After 5 Years
Revolving Credit Facility	$368,700	$—	$—	$368,700	$—
Convertible Notes	1,239,500	150,000	497,500	592,000	—
Public Notes	548,094	—	—	300,000	248,094
Prospect Capital InterNotes®	827,442	—	54,509	369,938	402,995
Total Contractual Obligations	$2,983,736	$150,000	$552,009	$1,630,638	$651,089

The following table shows the contractual maturities of our Revolving Credit Facility, Convertible Notes, Public Notes and Prospect Capital InterNotes® as of June 30, 2014.

	Payments Due by Period				
	Total	Less than 1 Year	1 – 3 Years	3 – 5 Years	After 5 Years
Revolving Credit Facility	$92,000	$ —	$92,000	$—	$—
Convertible Notes	1,247,500	—	317,500	530,000	400,000
Public Notes	647,881	—	—	—	647,881
Prospect Capital InterNotes®	785,670	—	8,859	261,456	515,355
Total Contractual Obligations	$2,773,051	$ —	$418,359	$791,456	$1,563,236

As permitted by ASC 825-10-25, we have not elected to value our Revolving Credit Facility, Convertible Notes, Public Notes and Prospect Capital InterNotes® at fair value. The following table shows the fair value of these financial liabilities disaggregated into the three levels of the ASC 820 valuation hierarchy as of June 30, 2015.

	Fair Value Hierarchy			
	Level 1	Level 2	Level 3	Total
Revolving Credit Facility(1)	$ —	$ 368,700	$ —	$368,700
Convertible Notes(2)	—	1,244,402	—	1,244,402
Public Notes(2)	—	564,052	—	564,052
Prospect Capital InterNotes®(3)	—	848,387	—	848,387
Total	$ —	$ 3,025,541	$ —	$3,025,541

(1) The carrying value of our Revolving Credit Facility approximates the fair value.

(2) We use available market quotes to estimate the fair value of the Convertible Notes and Public Notes.

(3) The fair value of Prospect Capital InterNotes® is estimated by discounting remaining payments using current Treasury rates.

The following table shows the fair value of these financial liabilities disaggregated into the three levels of the ASC 820 valuation hierarchy as of June 30, 2014.

	Fair Value Hierarchy			
	Level 1	Level 2	Level 3	Total
Revolving Credit Facility(1)	$ —	$ 92,000	$ —	$92,000
Convertible Notes(2)	—	1,293,495	—	1,293,495
Public Notes(2)	—	679,816	—	679,816
Prospect Capital InterNotes®(3)	—	799,631	—	799,631
Total	$ —	$ 2,864,942	$ —	$2,864,942

(1) The carrying value of our Revolving Credit Facility approximates the fair value.

(2) We use available market quotes to estimate the fair value of the Convertible Notes and Public Notes.

(3) The fair value of Prospect Capital InterNotes® is estimated by discounting remaining payments using current Treasury rates.

Note 9. Equity Offerings, Offering Expenses, and Distributions

Excluding dividend reinvestments, we issued 14,845,556 and 93,381,602 shares of our common stock during the years ended June 30, 2015 and June 30, 2014, respectively. The following table summarizes our issuances of common stock during the years ended June 30, 2014 and June 30, 2015.

Issuances of Common Stock	Number of Shares Issued	Gross Proceeds	Underwriting Fees	Offering Expenses	Average Offering Price
During the year ended June 30, 2014:					
July 5, 2013 – August 21, 2013(1)	9,818,907	$107,725	$ 902	$ 169	$ 10.97
August 2, 2013(2)	1,918,342	21,006	—	—	$ 10.95
August 29, 2013 – November 4, 2013(1)	24,127,242	272,114	2,703	414	$ 11.28
November 12, 2013 – February 5, 2014(1)	27,301,889	307,045	3,069	436	$ 11.25
February 10, 2014 – April 9, 2014(1)	21,592,715	239,305	2,233	168	$ 11.08
March 31, 2014(2)	2,306,294	24,908	—	—	$ 10.80
April 15, 2014 – May 2, 2014(1)	5,213,900	56,995	445	193	$ 10.93
May 5, 2014(2)	1,102,313	11,916	—	—	$ 10.81
During the year ended June 30, 2015:					
September 11, 2014 – November 3, 2014(1)	9,490,975	95,149	474	175	$ 10.03
November 17, 2014 – December 3, 2014(1)	5,354,581	51,678	268	469	$ 9.65

(1) Shares were issued in connection with our at-the-market offering program which we enter into from time to time with various counterparties.

(2) Shares were issued in conjunction with our investments in the following controlled portfolio companies: CP Holdings of Delaware LLC, Harbortouch Holdings of Delaware Inc., and Arctic Oilfield Equipment USA, Inc.

Our shareholders' equity accounts as of June 30, 2015 and June 30, 2014 reflect cumulative shares issued as of those respective dates. Our common stock has been issued through public offerings, a registered direct offering, the exercise of over-allotment options on the part of the underwriters, our dividend reinvestment plan and in connection with the acquisition of certain controlled portfolio companies. When our common stock is issued, the related offering expenses have been charged against paid-in capital in excess of par. All underwriting fees and offering expenses were borne by us.

On August 24, 2011, our Board of Directors approved a share repurchase plan (the "Repurchase Program") under which we may repurchase up to $100,000 of our common stock at prices below our net asset value per share. Prior to any repurchase, we are required to notify shareholders of our intention to purchase our common stock. Our last notice was delivered on June 16, 2015. This notice lasts for six months after notice is given. We did not make any purchases of our common stock during the period from August 24, 2011 to June 30, 2015 pursuant to the Repurchase Program. See Note 18 for shares purchased under the Repurchase Program subsequent to June 30, 2015.

Our Board of Directors, pursuant to the Maryland General Corporation Law, executed Articles of Amendment to increase the number of shares authorized for issuance from 500,000,000 to 1,000,000,000 in the aggregate. The amendment became effective May 6, 2014.

On November 4, 2014, our Registration Statement on Form N-2 was declared effective by the SEC. Under this Shelf Registration Statement, we can issue up to $4,822,626 of additional debt and equity securities in the public market as of June 30, 2015.

During the years ended June 30, 2015 and June 30, 2014, we distributed approximately $421,594 and $403,188, respectively, to our stockholders. The following table summarizes our distributions declared and payable for the years ended June 30, 2014 and June 30, 2015.

Declaration Date	Record Date	Payment Date	Amount Per Share	Amount Distributed (in thousands)
5/6/2013	7/31/2013	8/22/2013	$0.110175	$ 28,001
5/6/2013	8/30/2013	9/19/2013	0.110200	28,759
6/17/2013	9/30/2013	10/24/2013	0.110225	29,915
6/17/2013	10/31/2013	11/21/2013	0.110250	31,224
6/17/2013	11/29/2013	12/19/2013	0.110275	32,189
6/17/2013	12/31/2013	1/23/2014	0.110300	33,229
8/21/2013	1/31/2014	2/20/2014	0.110325	34,239
8/21/2013	2/28/2014	3/20/2014	0.110350	35,508
8/21/2013	3/31/2014	4/17/2014	0.110375	36,810
11/4/2013	4/30/2014	5/22/2014	0.110400	37,649
11/4/2013	5/30/2014	6/19/2014	0.110425	37,822
11/4/2013	6/30/2014	7/24/2014	0.110450	37,843
Total declared and payable for the year ended June 30, 2014				$ 403,188
2/3/2014	7/31/2014	8/21/2014	$0.110475	$ 37,863
2/3/2014	8/29/2014	9/18/2014	0.110500	37,885
2/3/2014	9/30/2014	10/22/2014	0.110525	38,519
5/6/2014	10/31/2014	11/20/2014	0.110550	38,977
5/6/2014	11/28/2014	12/18/2014	0.110575	39,583
5/6/2014	12/31/2014	1/22/2015	0.110600	39,623
9/24/2014	1/30/2015	2/19/2015	0.110625	39,648
12/8/2014	2/27/2015	3/19/2015	0.083330	29,878
12/8/2014	3/31/2015	4/23/2015	0.083330	29,887
12/8/2014	4/30/2015	5/21/2015	0.083330	29,898
5/6/2015	5/29/2015	6/18/2015	0.083330	29,910
5/6/2015	6/30/2015	7/23/2015	0.083330	29,923
Total declared and payable for the year ended June 30, 2015				$ 421,594

Dividends and distributions to common stockholders are recorded on the ex-dividend date. As such, the table above includes distributions with record dates during the years ended June 30, 2015 and June 30, 2014. It does not include distributions previously declared to stockholders of record on any future dates, as those amounts are not yet determinable. The following dividends were previously declared and will be payable subsequent to June 30, 2015:

- $0.08333 per share for July 2015 to holders of record on July 31, 2015 with a payment date of August 20, 2015;
- $0.08333 per share for August 2015 to holders of record on August 31, 2015 with a payment date of September 17, 2015;
- $0.08333 per share for September 2015 to holders of record on September 30, 2015 with a payment date of October 22, 2015; and
- $0.08333 per share for October 2015 to holders of record on October 30, 2015 with a payment date of November 19, 2015.

During the years ended June 30, 2015 and June 30, 2014, we issued 1,618,566 and 1,408,070 shares of our common stock, respectively, in connection with the dividend reinvestment plan.

As of June 30, 2015, we have reserved 102,790,062 shares of our common stock for issuance upon conversion of the Convertible Notes (see Note 5).

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Note 10. Other Income

Other income consists of structuring fees, overriding royalty interests, revenue receipts related to net profit interests, deal deposits, administrative agent fees, and other miscellaneous and sundry cash receipts. The following table shows income from such sources during the years ended June 30, 2015, 2014 and 2013.

	Year Ended June 30,		
	2015	2014	2013
Structuring and amendment fees (refer to Note 3)	$28,562	$59,527	$53,708
Recovery of legal costs from prior periods from legal settlement	—	5,825	—
Royalty interests	5,219	5,893	4,122
Administrative agent fees	666	468	346
Total Other Income	$34,447	$71,713	$58,176

Note 11. Net Increase in Net Assets per Share

The following information sets forth the computation of net increase in net assets resulting from operations per share during the years ended June 30, 2015, 2014 and 2013.

	Year Ended June 30,		
	2015	2014	2013
Net increase in net assets resulting from operations	$346,339	$ 319,020	$ 220,856
Weighted average common shares outstanding	353,648,522	300,283,941	207,069,971
Net increase in net assets resulting from operations per share	$0.98	$ 1.06	$ 1.07

Note 12. Income Taxes

While our fiscal year end for financial reporting purposes is June 30 of each year, our tax year end is August 31 of each year. The information presented in this footnote is based on our tax year end for each period presented, unless otherwise specified.

For income tax purposes, dividends paid and distributions made to shareholders are reported as ordinary income, capital gains, non-taxable return of capital, or a combination thereof. The tax character of dividends paid to shareholders during the tax years ended August 31, 2014, 2013 and 2012 were as follows:

	Tax Year Ended August 31,		
	2014	2013	2012
Ordinary income	$413,051	$282,621	$147,204
Capital gain	—	—	—
Return of capital	—	—	—
Total dividends paid to shareholders	$413,051	$282,621	$147,204

For the tax year ending August 31, 2015, the tax character of dividends paid to shareholders through June 30, 2015 is expected to be ordinary income. Because of the difference between our fiscal and tax year ends, the final determination of the tax character of dividends will not be made until we file our tax return for the tax year ending August 31, 2015.

Taxable income generally differs from net increase in net assets resulting from operations for financial reporting purposes due to temporary and permanent differences in the recognition of income and expenses, and generally excludes net unrealized gains or losses, as unrealized gains or losses are generally not included in taxable income until they are realized.

The following reconciles the net increase in net assets resulting from operations to taxable income for the tax years ended August 31, 2014, 2013 and 2012:

	Tax Year Ended August 31,		
	2014	2013	2012
Net increase in net assets resulting from operations	$317,671	$238,721	$208,331
Net realized loss (gain) on investments	28,244	24,632	(38,363)
Net unrealized depreciation on investments	24,638	77,835	32,367
Other temporary book-to-tax differences	(9,122)	(6,994)	(1,132)
Permanent differences	(4,317)	5,939	(6,103)
Taxable income before deductions for distributions	$357,114	$340,133	$195,100

Capital losses in excess of capital gains earned in a tax year may generally be carried forward and used to offset capital gains, subject to certain limitations. The Regulated Investment Company Modernization Act (the "RIC Modernization Act") was enacted on December 22, 2010. Under the RIC Modernization Act, capital losses incurred by taxpayers in taxable years beginning after the date of enactment will be allowed to be carried forward indefinitely and are allowed to retain their character as either short-term or long-term losses. As such, the capital loss carryforwards generated by us after the August 31, 2011 tax year will not be subject to expiration. Any losses incurred in post-enactment tax years will be required to be utilized prior to the losses incurred in pre-enactment tax years. As of August 31, 2014, we had capital loss carryforwards of approximately $117,393 available for use in later tax years. Of the amount available as of August 31, 2014, $623, $33,096 and $46,910 will expire on August 31, 2016, 2017 and 2018, respectively, and $36,764 is not subject to expiration. The unused balance each year will be carried forward and utilized as gains are realized, subject to limitations. While our ability to utilize losses in the future depends upon a variety of factors that cannot be known in advance, substantially all of our capital loss carryforwards may become permanently unavailable due to limitations by the Code.

Under current tax law, capital losses and specific ordinary losses realized after October 31st and December 31st, respectively, may be deferred and treated as occurring on the first business day of the following tax year. As of August 31, 2014, we had deferred $22,601 of long-term capital losses which will be treated as arising on the first day of the tax year ending August 31, 2015.

For the tax year ended August 31, 2014, we had distributions in excess of taxable income. After the excess distributions, we still had cumulative taxable income in excess of cumulative distributions, and therefore, we elected to carry forward the excess for distribution to shareholders in the tax year ending August 31, 2015. The amount carried forward to 2015 was approximately $49,471. For the tax year ended August 31, 2013, we had taxable income in excess of the distributions made from such taxable income during the year, and therefore, we elected to carry forward the excess for distribution to shareholders in the tax year ended August 31, 2014. The amount carried forward to 2014 was approximately $105,408. For the tax year ended August 31, 2012, we had taxable income in excess of the distributions made from such taxable income during the year, and therefore, we elected to carry forward the excess for distribution to shareholders in the tax year ended August 31, 2013. The amount carried forward to 2013 was approximately $47,896.

As of June 30, 2015, the cost basis of investments for tax purposes was $6,599,876 resulting in estimated gross unrealized appreciation and depreciation of $263,892 and $254,210, respectively. As of June 30, 2014, the cost basis of investments for tax purposes was $6,424,182 resulting in estimated gross unrealized appreciation and depreciation of $139,620 and $310,063, respectively. Due to the difference between our fiscal and tax year ends, the cost basis of our investments for tax purposes as of June 30, 2015 and June 30, 2014 was calculated based on the book cost of investments as of June 30, 2015 and June 30, 2014, respectively, with cumulative book-to-tax adjustments for investments through each investment's most current tax year end.

In general, we may make certain adjustments to the classification of net assets as a result of permanent book-to-tax differences, which may include merger-related items, differences in the book and tax basis of certain assets and liabilities, and nondeductible federal taxes, among other items. During the tax year ended August 31, 2014, we increased accumulated overdistributed net investment income by $4,316, decreased accumulated net realized loss on investments by $3,384 and increased capital in excess of par value by $932. During the tax year ended August 31, 2013, we increased accumulated undistributed net investment income by $5,939, increased accumulated net realized

loss on investments by $2,621 and decreased capital in excess of par value by $3,318. Due to the difference between our fiscal and tax year ends, the reclassifications for the taxable year ended August 31, 2014 are recorded in the fiscal year ending June 30, 2015 and the reclassifications for the taxable year ended August 31, 2013 were recorded in the fiscal year ended June 30, 2014.

Note 13. Related Party Agreements and Transactions
Investment Advisory Agreement
On December 23, 2014, the Investment Adviser, Prospect Capital Management LLC, converted into a Delaware limited partnership and is now known as Prospect Capital Management L.P. (continues as the “Investment Adviser”). We have entered into an investment advisory and management agreement with the Investment Adviser (the “Investment Advisory Agreement”) under which the Investment Adviser, subject to the overall supervision of our Board of Directors, manages the day-to-day operations of, and provides investment advisory services to, us. Under the terms of the Investment Advisory Agreement, the Investment Adviser: (i) determines the composition of our portfolio, the nature and timing of the changes to our portfolio and the manner of implementing such changes, (ii) identifies, evaluates and negotiates the structure of the investments we make (including performing due diligence on our prospective portfolio companies); and (iii) closes and monitors investments we make.
The Investment Adviser’s services under the Investment Advisory Agreement are not exclusive, and it is free to furnish similar services to other entities so long as its services to us are not impaired. For providing these services the Investment Adviser receives a fee from us, consisting of two components: a base management fee and an incentive fee. The base management fee is calculated at an annual rate of 2.00% on our gross assets (including amounts borrowed). For services currently rendered under the Investment Advisory Agreement, the base management fee is payable quarterly in arrears. The base management fee is calculated based on the average value of our gross assets at the end of the two most recently completed calendar quarters and appropriately adjusted for any share issuances or repurchases during the current calendar quarter.
The total base management fee incurred to the favor of the Investment Adviser was $134,590, $108,990 and $69,800 during the years ended June 30, 2015, 2014 and 2013, respectively.
The Investment Adviser has entered into a servicing agreement with certain institutions, where we serve as the agent and collect a servicing fee on behalf of the Investment Adviser. During the year ended June 30, 2015, we received payments of $170 from these institutions, on behalf of the Investment Adviser, for providing such services under the servicing agreement. We were given a credit for these payments as a reduction of base management fee payable by us to Prospect Capital Management.
The incentive fee has two parts. The first part, the income incentive fee, is calculated and payable quarterly in arrears based on our pre-incentive fee net investment income for the immediately preceding calendar quarter. For this purpose, pre-incentive fee net investment income means interest income, dividend income and any other income (including any other fees (other than fees for providing managerial assistance), such as commitment, origination, structuring, diligence and consulting fees and other fees that we receive from portfolio companies) accrued during the calendar quarter, minus our operating expenses for the quarter (including the base management fee, expenses payable under the Administration Agreement described below, and any interest expense and dividends paid on any issued and outstanding preferred stock, but excluding the incentive fee). Pre-incentive fee net investment income includes, in the case of investments with a deferred interest feature (such as original issue discount, debt instruments with payment-in-kind interest and zero coupon securities), accrued income that we have not yet received in cash.
Pre-incentive fee net investment income does not include any realized capital gains, realized capital losses or unrealized capital appreciation or depreciation. Pre-incentive fee net investment income, expressed as a rate of return on the value of our net assets at the end of the immediately preceding calendar quarter, is compared to a “hurdle rate” of 1.75% per quarter (7.00% annualized).
The net investment income used to calculate this part of the incentive fee is also included in the amount of the gross assets used to calculate the 2.00% base management fee. We pay the Investment Adviser an income incentive fee with respect to our pre-incentive fee net investment income in each calendar quarter as follows:

- No incentive fee in any calendar quarter in which our pre-incentive fee net investment income does not exceed the hurdle rate;
- 100.00% of our pre-incentive fee net investment income with respect to that portion of such pre-incentive fee net investment income, if any, that exceeds the hurdle rate but is less than 125.00% of the quarterly hurdle rate in any calendar quarter (8.75% annualized assuming a 7.00% annualized hurdle rate); and
- 20.00% of the amount of our pre-incentive fee net investment income, if any, that exceeds 125.00% of the quarterly hurdle rate in any calendar quarter (8.75% annualized assuming a 7.00% annualized hurdle rate).

These calculations are appropriately prorated for any period of less than three months and adjusted for any share issuances or repurchases during the current quarter.

The second part of the incentive fee, the capital gains incentive fee, is determined and payable in arrears as of the end of each calendar year (or upon termination of the Investment Advisory Agreement, as of the termination date), and equals 20.00% of our realized capital gains for the calendar year, if any, computed net of all realized capital losses and unrealized capital depreciation at the end of such year. In determining the capital gains incentive fee payable to the Investment Adviser, we calculate the aggregate realized capital gains, aggregate realized capital losses and aggregate unrealized capital depreciation, as applicable, with respect to each investment that has been in its portfolio. For the purpose of this calculation, an “investment” is defined as the total of all rights and claims which maybe asserted against a portfolio company arising from our participation in the debt, equity, and other financial instruments issued by that company. Aggregate realized capital gains, if any, equal the sum of the differences between the aggregate net sales price of each investment and the aggregate cost basis of such investment when sold or otherwise disposed. Aggregate realized capital losses equal the sum of the amounts by which the aggregate net sales price of each investment is less than the aggregate cost basis of such investment when sold or otherwise disposed. Aggregate unrealized capital depreciation equals the sum of the differences, if negative, between the aggregate valuation of each investment and the aggregate cost basis of such investment as of the applicable calendar year-end. At the end of the applicable calendar year, the amount of capital gains that serves as the basis for our calculation of the capital gains incentive fee involves netting aggregate realized capital gains against aggregate realized capital losses on a since-inception basis and then reducing this amount by the aggregate unrealized capital depreciation. If this number is positive, then the capital gains incentive fee payable is equal to 20.00% of such amount, less the aggregate amount of any capital gains incentive fees paid since inception.

The total income incentive fee incurred was $90,687, $89,306 and $81,231 during the years ended June 30, 2015, 2014 and 2013, respectively. No capital gains incentive fee was incurred during the years ended June 30, 2015, 2014 and 2013.

Administration Agreement

We have also entered into an administration agreement (the “Administration Agreement”) with Prospect Administration under which Prospect Administration, among other things, provides (or arranges for the provision of) administrative services and facilities for us. For providing these services, we reimburse Prospect Administration for our allocable portion of overhead incurred by Prospect Administration in performing its obligations under the Administration Agreement, including rent and our allocable portion of the costs of our Chief Financial Officer and Chief Compliance Officer and his staff. Under this agreement, Prospect Administration furnishes us with office facilities, equipment and clerical, bookkeeping and record keeping services at such facilities. Prospect Administration also performs, or oversees the performance of, our required administrative services, which include, among other things, being responsible for the financial records that we are required to maintain and preparing reports to our stockholders and reports filed with the SEC. In addition, Prospect Administration assists us in determining and publishing our net asset value, overseeing the preparation and filing of our tax returns and the printing and dissemination of reports to our stockholders, and generally oversees the payment of our expenses and the performance of administrative and professional services rendered to us by others. Under the Administration Agreement, Prospect Administration also provides on our behalf managerial assistance to those portfolio companies to which we are required to provide such assistance (see “Managerial Assistance” below). The Administration Agreement may be terminated by either party without penalty upon 60 days’ written notice to the other party. Prospect Administration is a subsidiary of the Investment Adviser.

The Administration Agreement provides that, absent willful misfeasance, bad faith or negligence in the performance of its duties or by reason of the reckless disregard of its duties and obligations, Prospect Administration and its officers, managers, partners, agents, employees, controlling persons, members and any other person or entity affiliated with it are entitled to indemnification from us for any damages, liabilities, costs and expenses (including reasonable attorneys’ fees and amounts reasonably paid in settlement) arising from the rendering of Prospect Administration’s services under the Administration Agreement or otherwise as administrator for us. Our payments to Prospect Administration are periodically reviewed by our Board of Directors.

The allocation of overhead expense from Prospect Administration was $21,906, $14,373 and $8,737 for the years ended June 30, 2015, 2014 and 2013, respectively. During the year ended June 30, 2015, Prospect Administration received payments of $6,929 directly from our portfolio companies for legal, tax and portfolio level accounting

services. We were given a credit for these payments as a reduction of the administrative services cost payable by us to Prospect Administration, resulting in net overhead expense of $14,977 during the year ended June 30, 2015. Had Prospect Administration not received these payments, Prospect Administration's charges for its administrative services would have increased by these amounts.

Managerial Assistance

As a BDC, we are obligated under the 1940 Act to make available to certain of our portfolio companies significant managerial assistance. "Making available significant managerial assistance" refers to any arrangement whereby we provide significant guidance and counsel concerning the management, operations, or business objectives and policies of a portfolio company. We are also deemed to be providing managerial assistance to all portfolio companies that we control, either by ourselves or in conjunction with others. The nature and extent of significant managerial assistance provided by us to controlled and non-controlled portfolio companies will vary according to the particular needs of each portfolio company. Examples of such activities include (i) advice on recruiting, hiring, management and termination of employees, officers and directors, succession planning and other human resource matters; (ii) advice on capital raising, capital budgeting, and capital expenditures; (iii) advice on advertising, marketing, and sales; (iv) advice on fulfillment, operations, and execution; (v) advice on managing relationships with unions and other personnel organizations, financing sources, vendors, customers, lessors, lessees, lawyers, accountants, regulators and other important counterparties; (vi) evaluating acquisition and divestiture opportunities, plant expansions and closings, and market expansions; (vii) participating in audit committee, nominating committee, board and management meetings; (viii) consulting with and advising board members and officers of portfolio companies (on overall strategy and other matters); and (ix) providing other organizational, operational, managerial and financial guidance.

Prospect Administration, when performing a managerial assistance agreement executed with each portfolio company to which we provide managerial assistance, arranges for the provision of such managerial assistance on our behalf. When doing so, Prospect Administration utilizes personnel of our Investment Adviser. We, on behalf of Prospect Administration, invoice portfolio companies receiving and paying for managerial assistance, and we remit to Prospect Administration its cost of providing such services, including the charges deemed appropriate by our Investment Adviser for providing such managerial assistance. No income was recognized by Prospect.

During the years ended June 30, 2015, 2014 and 2013, we received payments of $5,126, $6,612 and $4,776, respectively, from our portfolio companies for managerial assistance and subsequently remitted these amounts to Prospect Administration. During the year ended June 30, 2015, we incurred $2,400 of managerial assistance expense related to our consolidated entity First Tower Delaware which was included within allocation from Prospect Administration on our Consolidated Statement of Operations for the year ended June 30, 2015. Of this amount, $600 had not yet been paid by First Tower Delaware to Prospect Administration and was included within due to Prospect Administration on our Consolidated Statement of Assets and Liabilities as of June 30, 2015. See Note 14 for further discussion.

Co-Investments

On February 10, 2014, we received an exemptive order from the SEC (the "Order") that gave us the ability to negotiate terms other than price and quantity of co-investment transactions with other funds managed by the Investment Adviser or certain affiliates, including Priority Income Fund, Inc. and Pathway Energy Infrastructure Fund, Inc., subject to the conditions included therein. Under the terms of the relief permitting us to co-invest with other funds managed by our Investment Adviser or its affiliates, a "required majority" (as defined in Section 57(o) of the 1940 Act) of our independent directors must make certain conclusions in connection with a co-investment transaction, including that (1) the terms of the proposed transaction, including the consideration to be paid, are reasonable and fair to us and our stockholders and do not involve overreaching of us or our stockholders on the part of any person concerned and (2) the transaction is consistent with the interests of our stockholders and is consistent with our investment objective and strategies. In certain situations where co-investment with one or more funds managed by the Investment Adviser or its affiliates is not covered by the Order, such as when there is an opportunity to invest in different securities of the same issuer, the personnel of the Investment Adviser or its affiliates will need to decide which fund will proceed with the investment. Such personnel will make these determinations based on policies and procedures, which are designed to reasonably ensure that investment opportunities are allocated fairly and equitably among affiliated funds over time and in a manner that is consistent with applicable laws, rules and regulations. Moreover, except in certain circumstances, when relying on the Order, we will be unable to invest in any issuer in which one or more funds managed by the Investment Adviser or its affiliates has previously invested.

As of June 30, 2015, we had co-investments with Priority Income Fund, Inc. in the following CLO funds: Babson CLO Ltd. 2014-III; Cent CLO 21 Limited; CIFC Funding 2014-IV Investor, Ltd.; Galaxy XVII CLO, Ltd.; Halcyon

Loan Advisors Funding 2014-2 Ltd.; HarbourView CLO VII, Ltd.; Jefferson Mill CLO Ltd.; Mountain View CLO IX Ltd.; Symphony CLO XIV Ltd.; Voya CLO 2014-1, Ltd.; and Washington Mill CLO Ltd.

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Note 14. Transactions with Controlled Companies
The descriptions below detail the transactions which Prospect Capital Corporation ("Prospect") has entered into with each of our controlled companies. Certain of the controlled entities discussed below were consolidated effective July 1, 2014 (see Note 1). As such, transactions with these Consolidated Holding Companies for the year ended June 30, 2015 are presented on a consolidated basis.
Airmall Inc.
As of June 30, 2014, Prospect owned 100% of the equity of AMU Holdings Inc. ("AMU"), a Consolidated Holding Company. AMU owned 98% of Airmall Inc. (f/k/a Airmall USA Holdings, Inc.) ("Airmall"). Airmall is a developer and manager of airport retail operations.
On July 30, 2010, Prospect made a $22,420 investment in AMU, of which $12,500 was a senior subordinated note and $9,920 was used to purchase 100% of the preferred and common equity of AMU. AMU used its combined debt and equity proceeds of $22,420 to purchase 100% of Airmall's common stock for $18,000, to pay $1,573 of structuring fees from AMU to Prospect (which was recognized by Prospect as structuring fee income), $836 of third party expenses, $11 of legal services provided by attorneys at Prospect Administration, and $2,000 of withholding tax. Prospect then purchased for $30,000 two loans of Airmall payable to unrealized third parties, one for $10,000 and the other $20,000. Prospect and Airmall subsequently refinanced the two loans into a single $30,000 loan from Airmall to Prospect.
On October 1, 2013, Prospect made an additional $2,600 investment in the senior subordinated note, of which $575 was utilized by AMU to pay interest due to Prospect and $2,025 was retained by AMU for working capital. On November 25, 2013, Prospect funded an additional $5,000 to the senior subordinated note, which was utilized by AMU to pay a $5,000 dividend to Prospect. On December 4, 2013, Prospect sold 2% of the outstanding principal balance of the senior secured term loan to Airmall and 2% of the outstanding principal balance of the senior subordinated note to AMU for $972.
On June 13, 2014, Prospect made a new $19,993 investment as a senior secured loan to Airmall. Airmall then distributed this amount to AMU as a return of capital, which AMU used to pay down the senior subordinated loan in the same amount. The minority interest held by a third party in AMU was exchanged for common stock of Airmall.
On July 1, 2014, Prospect began consolidating AMU. As a result, any transactions between AMU and Prospect are eliminated in consolidation and as such, transactions after July 1, 2014 are not presented below.
On August 1, 2014, Prospect sold its investments in Airmall for net proceeds of $51,379 and realized a loss of $3,473 on the sale. In addition, there is $6,000 being held in escrow, of which 98% is due to Prospect, which will be recognized as an additional realized loss if it is not received. Included in the net proceeds were $3,000 of structuring fees from Airmall related to the sale of the operating company which was recognized as other income during the year ended June 30, 2015. On October 22, 2014, Prospect received a tax refund of $665 related to its investment in Airmall and realized a gain of the same amount.
In addition to the repayments noted above, the following amounts were paid from Airmall to Prospect and recorded by Prospect as repayment of loan receivable:

Year Ended June 30, 2013	$600
Year Ended June 30, 2014	593
Year Ended June 30, 2015	49

The following dividends were declared and paid from Airmall to AMU and recognized as dividend income by AMU:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	7,000
Year Ended June 30, 2015	N/A

The following dividends were declared and paid from AMU to Prospect and recognized as dividend income by Prospect:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	12,000
Year Ended June 30, 2015	N/A

Explanation of Responses:

All dividends were paid from earnings and profits of Airmall and AMU.
The following interest payments were accrued and paid from AMU to Prospect and recognized by Prospect as interest income:

Year Ended June 30, 2013	$2,286
Year Ended June 30, 2014	3,159
Year Ended June 30, 2015	N/A

Included above, the following payment-in-kind interest from AMU was capitalized and recognized by Prospect as interest income:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	295
Year Ended June 30, 2015	N/A

The following interest payments were accrued and paid from Airmall to Prospect and recognized by Prospect as interest income:

Year Ended June 30, 2013	$3,536
Year Ended June 30, 2014	3,420
Year Ended June 30, 2015	576

The following interest income recognized had not yet been paid by Airmall to Prospect and was included by Prospect within interest receivable:

June 30, 2014	$920
June 30, 2015	—

The following managerial assistance payments were paid from AMU to Prospect and subsequently remitted to Prospect Administration (no income was recognized by Prospect):

Year Ended June 30, 2013	$225
Year Ended June 30, 2014	300
Year Ended June 30, 2015	N/A

The following managerial assistance payments were paid from Airmall to Prospect and subsequently remitted to Prospect Administration (no income was recognized by Prospect):

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	—
Year Ended June 30, 2015	75

The following managerial assistance recognized had not yet been paid by Airmall to Prospect and was included by Prospect within other receivables and due to Prospect Administration:

June 30, 2014	$75
June 30, 2015	—

The following payments were paid from Airmall to Prospect Administration as reimbursement for legal, tax and portfolio level accounting services provided directly to Airmall (no direct income was recognized by Prospect, but Prospect was given credit for these payments as a reduction of the administrative services costs payable by Prospect to Prospect Administration):

Year Ended June 30, 2013	$ 8
Year Ended June 30, 2014	—
Year Ended June 30, 2015	730

The following amounts were due from Airmall to Prospect for reimbursement of expenses paid by Prospect on behalf of Airmall and were included by Prospect within other receivables:
June 30, 2014 $11
June 30, 2015 —
American Property REIT Corp.
Prospect owns 100% of the equity of APH Property Holdings, LLC (“APH”), a Consolidated Holding Company. APH owns 100% of the common equity of American Property REIT Corp. (f/k/a American Property Holdings Corp.) (“APRC”). APRC is a Maryland corporation and a qualified REIT for federal income tax purposes. In order to qualify as a REIT, APRC issued 125 shares of Series A Cumulative Non-Voting Preferred Stock to 125 accredited investors. The preferred stockholders are entitled to receive cumulative dividends semi-annually at an annual rate of 12.5% and do not have the ability to participate in the management or operation of APRC.
APRC was formed to hold for investment, operate, finance, lease, manage, and sell a portfolio of real estate assets and engage in any and all other activities as may be necessary, incidental or convenient to carry out the foregoing. APRC acquires real estate assets, including, but not limited to, industrial, commercial, and multi-family properties. APRC may acquire real estate assets directly or through joint ventures by making a majority equity investment in a property-owning entity (the “JV”).
On October 24, 2012, Prospect initially made a $7,808 investment in APH, of which $6,000 was a Senior Term Loan and $1,808 was used to purchase the membership interests of APH. The proceeds were utilized by APH to purchase APRC common equity for $7,806, with $2 retained by APH for working capital. The proceeds were utilized by APRC to purchase a 100% ownership interest in 146 Forest Parkway, LLC for $7,326, pay a $250 non-refundable deposit and $222 of structuring fees to Prospect (which was recognized by Prospect as structuring fee income), with $8 retained by APRC for working capital. 146 Forest Parkway, LLC was purchased for $7,400. The remaining proceeds were used to pay $168 of third party expenses and $5 of legal services provided by attorneys at Prospect Administration, with $3 retained by the JV for working capital. The investment was subsequently contributed to NPRC.
On December 28, 2012, Prospect made a $9,594 investment in APH, of which $6,400 was a Senior Term Loan and $3,194 was used to purchase additional membership interests of APH. The proceeds were utilized by APH to purchase additional APRC common equity for $9,594. The proceeds were utilized by APRC to purchase a 92.7% ownership interest in 1557 Terrell Mill Road, LLC for $9,548, with $46 retained by APRC for other expenses. The JV was purchased for $23,500 which included debt financing and minority interest of $15,275 and $757, respectively. The remaining proceeds were used to pay $286 of structuring fees to Prospect (which was recognized by Prospect as structuring fee income) and $1,652 of third party expenses, with $142 retained by the JV for working capital.
On January 17, 2013, Prospect made a $30,348 investment in APH, of which $27,600 was a Senior Term Loan and $2,748 was used to purchase additional membership interests of APH. The proceeds were utilized by APH to purchase additional APRC common equity for $29,348, with $1,000 retained by APH for working capital. The proceeds were utilized by APRC to purchase a 97.7% ownership interest in 5100 Live Oaks Blvd, LLC for $29,348. The JV was purchased for $63,400 which included debt financing and minority interest of $39,600 and $686, respectively. The remaining proceeds were used to pay $880 of structuring fees to Prospect (which was recognized by Prospect as structuring fee income), $4,265 of third party expenses, $14 of legal services provided by attorneys at Prospect Administration, and $1,030 of prepaid assets, with $45 retained by the JV for working capital. The investment was subsequently contributed to NPRC.
On April 30, 2013, Prospect made a $10,383 investment in APH, of which $9,000 was a Senior Term Loan and $1,383 was used to purchase additional membership interests of APH. The proceeds were utilized by APH to purchase additional APRC common equity for $10,233, with $150 retained by APH for working capital. The proceeds were utilized by APRC to purchase a 93.2% ownership interest in Lofton Place, LLC for $10,233. The JV was purchased for $26,000 which included debt financing and minority interest of $16,965 and $745, respectively. The remaining proceeds were used to pay $306 of structuring fees to Prospect (which was recognized by Prospect as structuring fee income), $1,223 of third party expenses, $5 of legal services provided by attorneys at Prospect Administration, and $364 of prepaid assets, with $45 retained by the JV for working capital.

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On April 30, 2013, Prospect made a $10,863 investment in APH, of which $9,000 was a Senior Term Loan and $1,863 was used to purchase additional membership interests of APH. The proceeds were utilized by APH to purchase additional APRC common equity for $10,708, with $155 retained by APH for working capital. The proceeds were utilized by APRC to purchase a 93.2% ownership interest in Vista Palma Sola, LLC for $10,708. The JV was purchased for $27,000 which included debt financing and minority interest of $17,550 and $785, respectively. The remaining proceeds were used to pay $321 of structuring fees to Prospect (which was recognized by Prospect as structuring fee income), $1,272 of third party expenses, $4 of legal services provided by attorneys at Prospect Administration, and $401 of prepaid assets, with $45 retained by the JV for working capital.
On May 8, 2013, Prospect made a $6,118 investment in APH, of which $4,000 was a Senior Term Loan and $2,118 was used to purchase additional membership interests of APH. The proceeds were utilized by APH to purchase additional APRC common equity for $6,028, with $90 retained by APH for working capital. The proceeds were utilized by APRC to purchase a 93.3% ownership interest in Arlington Park Marietta, LLC for $6,028. Arlington Park Marietta, LLC was purchased for $14,850 which included debt financing and minority interest of $9,650 and $437, respectively. The remaining proceeds were used to pay $181 of structuring fees to Prospect (which was recognized by Prospect as structuring fee income), $911 of third party expenses, and $128 of prepaid assets, with $45 retained by the JV for working capital.
On June 24, 2013, Prospect made a $76,533 investment in APH, of which $63,000 was a Senior Term Loan and $13,533 was used to purchase additional membership interests of APH. The proceeds were utilized by APH to purchase additional APRC common equity for $75,233, with $1,300 retained by APH for working capital. The proceeds were utilized by APRC to purchase a 95.0% ownership interest in APH Carroll Resort, LLC for $74,398 and to pay $835 of structuring fees to Prospect (which was recognized by Prospect as structuring fee income). The JV was purchased for $225,000 which included debt financing and minority interest of $157,500 and $3,916, respectively. The remaining proceeds were used to pay $1,436 of structuring fees to Prospect (which was recognized by Prospect as structuring fee income), $7,687 of third party expenses, $8 of legal services provided by attorneys at Prospect Administration, and $1,683 of prepaid assets. The investment was subsequently contributed to NPRC and renamed NPRC Carroll Resort, LLC.
Between October 29, 2013 and December 4, 2013, Prospect made an $11,000 investment in APH, of which $9,350 was a Senior Term Loan and $1,650 was used to purchase additional membership interests of APH. The proceeds were utilized by certain of APH’s wholly-owned subsidiaries to purchase online consumer loans from a third party. The investment was subsequently contributed to NPRC.
On November 1, 2013, Prospect made a $9,869 investment in APH, of which $8,200 was a Senior Term Loan and $1,669 was used to purchase additional membership interests of APH. The proceeds were utilized by APH to purchase additional APRC common equity for $9,869. The proceeds were utilized by APRC to purchase a 94.0% ownership interest in APH Carroll 41, LLC for $9,548 and to pay $102 of structuring fees to Prospect (which was recognized by Prospect as structuring fee income), with $219 retained by APRC for working capital. The JV was purchased for $30,600 which included debt financing and minority interest of $22,497 and $609, respectively. The remaining proceeds were used to pay $190 of structuring fees to Prospect (which was recognized by Prospect as structuring fee income), $1,589 of third party expenses, $5 of legal services provided by attorneys at Prospect Administration, and $270 of prepaid assets. The investment was subsequently contributed to NPRC.
On November 15, 2013, Prospect made a $45,900 investment in APH, of which $38,500 was a Senior Term Loan and $7,400 was used to purchase additional membership interests of APH. The proceeds were utilized by APH to purchase additional APRC common equity for $45,900. The proceeds were utilized by APRC to purchase a 99.3% ownership interest in APH Gulf Coast Holdings, LLC for $45,024 and to pay $364 of structuring fees to Prospect (which was recognized by Prospect as structuring fee income), with $512 retained by APRC for working capital. The JV was purchased for $115,200 which included debt financing and minority interest of $75,558 and $337, respectively. The remaining proceeds were used to pay $1,013 of structuring fees to Prospect (which was recognized by Prospect as structuring fee income), $2,590 of third party expenses, $23 of legal services provided by attorneys at Prospect Administration, and $2,023 of prepaid assets, with $70 retained by the JV for working capital.
On November 19, 2013, Prospect made a $66,188 investment in APH, of which $55,000 was a Senior Term Loan and $11,188 was used to purchase additional membership interests of APH. The proceeds were utilized by APH to

purchase additional APRC common equity for $66,188. The proceeds were utilized by APRC to purchase a 90.0% ownership interest in APH McDowell, LLC for $64,392 and to pay $695 of structuring fees to Prospect (which was recognized by Prospect as structuring fee income), with $1,101 retained by APRC for working capital. The JV was purchased for $238,605 which included debt financing and minority interest of $180,226 and $7,155, respectively. The remaining proceeds were used to pay $1,290 of structuring fees to Prospect (which was recognized by Prospect as structuring fee income), $9,205 of third party expenses, $23 of legal services provided by attorneys at Prospect Administration, and $1,160 of prepaid assets, with $1,490 retained by the JV for working capital. The investment was subsequently contributed to NPRC and renamed NPH McDowell, LLC.

On December 12, 2013, Prospect made a $22,507 investment in APH, of which $18,800 was a Senior Term Loan and $3,707 was used to purchase additional membership interests of APH. The proceeds were utilized by APH to purchase additional APRC common equity for $22,507. The proceeds were utilized by APRC to purchase a 92.6% ownership interest in South Atlanta Portfolio Holding Company, LLC for $21,874 and to pay $238 of structuring fees to Prospect (which was recognized by Prospect as structuring fee income), with $395 retained by APRC for working capital. The JV was purchased for $87,250 which included debt financing and minority interest of $67,493 and $1,756, respectively. The remaining proceeds were used to pay $437 of structuring fees to Prospect (which was recognized by Prospect as structuring fee income), $2,920 of third party expenses, and $116 of prepaid assets, with $400 retained by the JV for working capital. The investment was subsequently contributed to UPRC.

On December 31, 2013, APRC distributed its majority interests in five JVs holding real estate assets to APH. APH then distributed these JV interests to Prospect in a transaction characterized as a return of capital. Prospect, on the same day, contributed certain of these JV interests to NPH Property Holdings, LLC and the remainder to UPH Property Holdings, LLC (each wholly-owned subsidiaries of Prospect). Each of NPH and UPH immediately thereafter contributed these JV interests to NPRC and UPRC, respectively. The total investments in the JVs transferred consisted of $98,164 and $20,022 of debt and equity financing, respectively. There was no material gain or loss realized on these transactions.

On January 17, 2014, Prospect made a $6,565 investment in APH, of which $5,500 was a Senior Term Loan and $1,065 was used to purchase additional membership interests of APH. The proceeds were utilized by APH to purchase additional APRC common equity for $6,565. The proceeds were utilized by APRC to purchase a 99.3% ownership interest in APH Gulf Coast Holdings, LLC for $6,336 and to pay $54 of structuring fees to Prospect (which was recognized by Prospect as structuring fee income), with $175 retained by APRC for other expenses. The JV was purchased for $15,430 which included debt financing and minority interest of $10,167 and $48, respectively. The remaining proceeds were used to pay $143 of structuring fees to Prospect (which was recognized by Prospect as structuring fee income), $627 of third party expenses, $4 of legal services provided by attorneys at Prospect Administration, and $312 of prepaid assets, with $35 retained by the JV for working capital.

Effective April 1, 2014, Prospect made a new $167,162 senior term loan to APRC. APRC then distributed this amount to APH as a return of capital which was used to pay down the Senior Term Loan from APH by the same amount.

On June 4, 2014, Prospect made a $1,719 investment in APH to purchase additional membership interests of APH, which was revised to $1,732 on July 1, 2014. The proceeds were utilized by APH to purchase additional APRC common equity for $1,732. The proceeds were utilized by APRC to acquire the real property located at 975 South Cornwell, Yukon, OK (“Taco Bell, OK”) for $1,719 and pay $13 of third party expenses.

On July 1, 2014, Prospect began consolidating APH. As a result, any transactions between APH and Prospect are eliminated in consolidation and as such, transactions after July 1, 2014 are not presented below.

On November 26, 2014, APRC transferred its investment in APH Carroll Resort, LLC to NPRC and the investment was renamed NPRC Carroll Resort, LLC. As a result, Prospect’s investments in APRC related to this property also transferred to NPRC. The investments transferred consisted of $10,237 of equity and $65,586 of debt. There was no gain or loss realized on the transaction.

On May 1, 2015, APRC transferred its investment in 5100 Live Oaks Blvd, LLC to NPRC. As a result, Prospect’s investments in APRC related to this property also transferred to NPRC. The investments transferred consisted of $2,748 of equity and $29,990 of debt. There was no gain or loss realized on the transaction.

On May 6, 2015, Prospect made a $1,475 investment in APRC, of which $1,381 was a Senior Term Loan and $94 was used to purchase additional common equity of APRC through APH. The proceeds were utilized by APRC to purchase additional ownership interest in its twelve multi-family properties for $1,473 and pay $2 of legal services provided by attorneys at Prospect Administration. The minority interest holder also invested an additional $17 in the JVs. The proceeds were used by the JVs to fund $1,490 of capital expenditures.

During the year ended June 30, 2015, Prospect received $8 as a return of capital on the equity investment in APRC.

The following dividends were declared and paid from APRC to APH (partially via a wholly-owned subsidiary of APH) and recognized as dividend income by APH:

Year Ended June 30, 2013	$1,676
Year Ended June 30, 2014	8,810

Year Ended June 30, 2015 —
All dividends were paid from earnings and profits of APRC.

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The following interest payments were accrued and paid from APH to Prospect and recognized by Prospect as interest income:

Year Ended June 30, 2013	$2,898
Year Ended June 30, 2014	13,928
Year Ended June 30, 2015	N/A

Included above, the following payment-in-kind interest from APH was capitalized and recognized by Prospect as interest income:

Year Ended June 30, 2013	$892
Year Ended June 30, 2014	4,084
Year Ended June 30, 2015	N/A

The following interest payments were accrued and paid from APRC to Prospect and recognized by Prospect as interest income:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	4,860
Year Ended June 30, 2015	14,747

Included above, the following payment-in-kind interest from APRC was capitalized and recognized by Prospect as interest income:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	581
Year Ended June 30, 2015	4,529

The following interest income recognized had not yet been paid by APRC to Prospect and was included by Prospect within interest receivable:

June 30, 2014	$54
June 30, 2015	25

The following royalty payments were paid from APH to Prospect and recognized by Prospect as other income:

Year Ended June 30, 2013	$140
Year Ended June 30, 2014	1,418
Year Ended June 30, 2015	N/A

The following royalty payments were paid from APRC to Prospect and recognized by Prospect as other income:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	—
Year Ended June 30, 2015	1,342

The following managerial assistance payments were paid from APRC to Prospect and subsequently remitted to Prospect Administration (no income was recognized by Prospect):

Year Ended June 30, 2013	$148
Year Ended June 30, 2014	637
Year Ended June 30, 2015	590

The following managerial assistance payments received by Prospect had not yet been remitted to Prospect Administration and were included by Prospect within due to Prospect Administration:

June 30, 2014	$148
June 30, 2015	148

The following payments were paid from APRC to Prospect Administration as reimbursement for legal, tax and portfolio level accounting services provided directly to APRC (no direct income was recognized by Prospect, but Prospect was given credit for these payments as a reduction of the administrative services costs payable by Prospect to Prospect Administration):

Year Ended June 30, 2013	$ 90
Year Ended June 30, 2014	1,791
Year Ended June 30, 2015	301

The following amounts were due from APRC to Prospect for reimbursement of expenses paid by Prospect on behalf of APRC and were included by Prospect within other receivables:

June 30, 2014	$202
June 30, 2015	124

Arctic Energy Services, LLC

Prospect owns 100% of the equity of Arctic Oilfield Equipment USA, Inc. (“Arctic Equipment”), a Consolidated Holding Company. Arctic Equipment owns 70% of the equity of Arctic Energy Services, LLC (“Arctic Energy”), with Ailport Holdings, LLC (“Ailport”) (100% owned and controlled by Arctic Energy management) owning the remaining 30% of the equity of Arctic Energy. Arctic Energy provides oilfield service personnel, well testing flowback equipment, frac support systems and other services to exploration and development companies in the Rocky Mountains.

On May 5, 2014, Prospect initially purchased 100% of the common shares of Arctic Equipment for $9,006. Proceeds were utilized by Arctic Equipment to purchase 70% of Arctic Energy as described in the following paragraph.

On May 5, 2014, Prospect made an additional $51,870 investment (including in exchange for 1,102,313 common shares of Prospect at fair value of $11,916) in Arctic Energy in exchange for a $31,640 senior secured loan and a $20,230 subordinated loan. Total proceeds received by Arctic Energy of $60,876 were used to purchase 70% of the equity interests in Arctic Energy from Ailport for $47,516, pay $875 of third-party expenses, $1,713 of structuring fees to Prospect (which was recognized as structuring fee income), $445 of legal services provided by attorneys at Prospect Administration and $10,327 was retained as working capital.

On July 1, 2014, Prospect began consolidating Arctic Equipment. As a result, any transactions between Arctic Equipment and Prospect are eliminated in consolidation and as such, transactions after July 1, 2014 are not presented below.

The following interest payments were accrued and paid from Arctic Energy to Prospect and recognized by Prospect as interest income:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	1,050
Year Ended June 30, 2015	6,721

The following interest income recognized had not yet been paid by Arctic Energy to Prospect and was included by Prospect within interest receivable:

June 30, 2014	$18
June 30, 2015	18

The following managerial assistance payments were paid from Arctic Energy to Prospect and subsequently remitted to Prospect Administration (no income was recognized by Prospect):

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	15
Year Ended June 30, 2015	100

The following managerial assistance payments received by Prospect had not yet been remitted to Prospect Administration and were included by Prospect within due to Prospect Administration:
June 30, 2014 $15
June 30, 2015 25
The following payments were paid from Arctic Energy to Prospect Administration as reimbursement for legal, tax and portfolio level accounting services provided directly to Arctic Energy (no direct income was recognized by Prospect, but Prospect was given credit for these payments as a reduction of the administrative services costs payable by Prospect to Prospect Administration):
Year Ended June 30, 2013 $ —
Year Ended June 30, 2014 445
Year Ended June 30, 2015 —
The following amounts were due from Arctic Energy to Prospect for reimbursement of expenses paid by Prospect on behalf of Arctic Energy and were included by Prospect within other receivables:
June 30, 2014 $6
June 30, 2015 —
The following amounts were due to Arctic Energy from Prospect for reimbursement of expenses paid by Arctic Energy on behalf of Prospect and were included by Prospect within other liabilities:
June 30, 2014 $—
June 30, 2015 1
ARRM Services, Inc.
As of June 30, 2014, Prospect owned 79.53% of the fully-diluted common, 85.76% of the Series A Preferred and 100% of the Series B Preferred equity of ARRM Services, Inc. (f/k/a ARRM Holdings, Inc.) (“ARRM”). ARRM owned 100% of the equity of Ajax Rolled Ring & Machine, LLC (f/k/a Ajax Rolled Ring & Machine, Inc.) (“Ajax”). Ajax forges large seamless steel rings on two forging mills in the company’s York, South Carolina facility. The rings are used in a range of industrial applications, including in construction equipment and power turbines. Ajax also provides machining and other ancillary services.
As of July 1, 2011, the cost basis of Prospect’s total debt and equity investment in Ajax was $41,699, including capitalized payment-in-kind interest of $3,535. Prospect’s investment in Ajax consisted of the following: $20,607 of senior secured term debt (“Tranche A Term Loan”); $15,035 of subordinated secured term debt (“Tranche B Term Loan”); and $6,057 of common equity. In October 2011, ARRM assumed Ajax’s Tranche B Term Loan and the equity of Ajax was exchanged for equity in ARRM. Ajax was converted into a limited liability company shortly thereafter. On December 28, 2012, Prospect provided an additional $3,600 of unsecured debt to ARRM (“Promissory Demand Note”). On April 1, 2013, Prospect refinanced its investment in Ajax and ARRM, increasing the total size of the debt investment to $38,537. The $19,837 Tranche A Term Loan was replaced with a new senior secured term loan to Ajax in the same amount. The $15,035 Tranche B Term Loan and $3,600 Promissory Demand Note were replaced with a new subordinated unsecured term loan to ARRM in the amount of $18,700. Prospect received $50 and $46 of structuring fees from Ajax and ARRM, respectively, which were recognized as other income.
On June 28, 2013, Prospect provided an additional $1,000 in the ARRM subordinated unsecured term loan to fund equity into Ajax. The proceeds were used by Ajax to repay senior debt to a third party. On October 11, 2013, Prospect provided $25,000 in preferred equity for the recapitalization of ARRM. After the financing, Prospect received repayment of the $20,008 subordinated unsecured term loan previously outstanding from ARRM. In March 2014, Prospect received $98 of structuring fees from Ajax related to the amendment of the loan agreement in September 2013.

On October 10, 2014, ARRM sold Ajax to a third party and repaid the $19,337 loan receivable to Prospect and Prospect recorded a realized loss of $23,560 related to the sale. Concurrent with the sale, Prospect's ownership increased to 100% of the outstanding equity of ARRM Services, Inc. which was renamed SB Forging Company, Inc. ("SB Forging"). As such, Prospect began consolidating SB Forging on October 11, 2014. In addition, there is $3,000 being held in escrow of which $802 was received on May 6, 2015 for which Prospect realized a gain of the same amount. The remainder of the escrow will be recognized as additional gain if and when received. Prospect received $2,000 of structuring fees from Ajax related to the sale of the operating company which was recognized as other income during the year ended June 30, 2015.

In addition to the repayments noted above, the following amounts were paid from Ajax to Prospect and recorded by Prospect as repayment of loan receivable:

Year Ended June 30, 2013 $430
Year Ended June 30, 2014 400
Year Ended June 30, 2015 —

The following interest payments, including prepayment penalty fees, were accrued and paid from ARRM to Prospect and recognized by Prospect as interest income:

Year Ended June 30, 2013 $993
Year Ended June 30, 2014 1,029
Year Ended June 30, 2015 —

Included above, the following payment-in-kind interest from ARRM was capitalized and recognized by Prospect as interest income:

Year Ended June 30, 2013 $ —
Year Ended June 30, 2014 309
Year Ended June 30, 2015 —

The following interest payments, including prepayment penalty fees, were accrued and paid from Ajax to Prospect and recognized by Prospect as interest income:

Year Ended June 30, 2013 $4,183
Year Ended June 30, 2014 2,082
Year Ended June 30, 2015 956

As of June 30, 2014, due to the pending sale transaction, Prospect reversed $3,844 of previously recognized payment-in-kind interest which we did not expect to receive.

The following interest income recognized had not yet been paid by Ajax to Prospect and was included by Prospect within interest receivable:

June 30, 2014 $6
June 30, 2015 —

The following managerial assistance payments were paid from Ajax to Prospect and subsequently remitted to Prospect Administration (no income was recognized by Prospect):

Year Ended June 30, 2013 $225
Year Ended June 30, 2014 180
Year Ended June 30, 2015 45

The following managerial assistance payments received by Prospect had not yet been remitted to Prospect Administration and were included by Prospect within due to Prospect Administration:

June 30, 2014 $45
June 30, 2015 —

The following payments were paid from ARRM to Prospect Administration as reimbursement for legal, tax and portfolio level accounting services provided directly to ARRM (no direct income was recognized by Prospect, but Prospect was given credit for these payments as a reduction of the administrative services costs payable by Prospect to Prospect Administration):

Year Ended June 30, 2013 $ 63
Year Ended June 30, 2014 17
Year Ended June 30, 2015 1,485

The following amounts were due from Ajax to Prospect for reimbursement of expenses paid by Prospect on behalf of Ajax and were included by Prospect within other receivables:

June 30, 2014 $2
June 30, 2015 —

Borga, Inc.

As of June 30, 2014, Prospect owned 100% of the equity of STI Holding, Inc. ("STI"), a Consolidated Holding Company. STI owned 100% of the equity of Borga, Inc. ("Borga"). Borga manufactures pre-engineered metal buildings and components for the agricultural and light industrial markets.

On May 6, 2005, Patriot Capital Funding, Inc. ("Patriot") (previously acquired by Prospect) provided $14,000 in senior secured debt to Borga. The debt was comprised of $1,000 Senior Secured Revolver, $3,500 Senior Secured Term Loan A, $2,500 Senior Secured Term Loan B and $7,000 Senior Secured Term Loan C. On March 31, 2009, Borga made its final amortization payment on the Senior Secured Term Loan A. The other loans remained outstanding. Prospect owned warrants to purchase 33,750 shares of common stock in Metal Buildings Holding Corporation ("Metal Buildings"), the former holding company of Borga. Metal Buildings owned 100% of Borga.

On March 8, 2010, Prospect acquired the remaining common stock of Borga.

On January 24, 2014, Prospect contributed its holdings in Borga to STI. STI also held $3,371 of proceeds from the sale of a minority equity interest in Smart Tuition Holdings, LLC ("SMART"). Prospect initially acquired membership interests in SMART indirectly as part of the Patriot acquisition on December 2, 2009 recording a zero cost basis for the equity investment. The $3,371 was distributed to Prospect on May 29, 2014, of which $3,246 was paid from earnings and profits of STI and was recognized as dividend income by Prospect. The remaining $125 was recognized as return of capital by Prospect.

On July 1, 2014, Prospect began consolidating STI. As a result, any transactions between STI and Prospect are eliminated in consolidation and as such, transactions after July 1, 2014 are not presented below.

On August 20, 2014, Prospect sold the assets of Borga, a wholly-owned subsidiary of STI, for net proceeds of $382 and realized a loss of $2,589 on the sale. On December 29, 2014, Borga was dissolved.

BXC Company, Inc.

As of June 30, 2014, Prospect owned 86.7% of Series A Preferred Stock, 96.8% of Series B Preferred Stock, and 83.1% of fully diluted common stock of BXC Company, Inc. (f/k/a BXC Holding Company) ("BXC"). BXC owned 100% of the common stock of Boxercraft Incorporated ("Boxercraft").

As of July 1, 2012, the cost basis of Prospect's total debt and equity investment in Boxercraft was $15,123, including capitalized payment-in-kind interest of $1,466. On December 31, 2013, Boxercraft repaid $100 of the senior secured term loan. On April 18, 2014, Prospect made a new $300 senior secured term loan to Boxercraft. During the period from July 1, 2012 through June 30, 2014, Prospect capitalized a total of $804 of paid-in-kind interest and accreted a total of $1,321 of the original purchase discount, increasing the total debt investment to $17,448 as of June 30, 2014.

Effective March 28, 2014, Prospect acquired voting control of BXC pursuant to a voting agreement and irrevocable proxy. Effective May 8, 2014, Prospect acquired control of BXC by transferring shares held by the other equity holders of BXC to Prospect pursuant to an assignment agreement entered into with such other equity holders.

On July 2, 2014, Prospect made a new $250 senior secured term loan to provide liquidity to Boxercraft.

On July 17, 2014, Prospect restructured the investments in BXC and Boxercraft. The existing Senior Secured Term Loan A and a portion of the existing Senior Secured Term Loan B were replaced with a new Senior Secured Term Loan A to Boxercraft. The remainder of the existing Senior Secured Term Loan B and the existing Senior Secured Term Loan C, Senior Secured Term Loan D, and Senior Secured Term Loan E were replaced with a new Senior Secured Term Loan B to Boxercraft. The existing Senior Secured Term Loan to Boxercraft was converted into Series D Preferred Stock in BXC.

During the year ended June 30, 2015, Prospect accrued $5 of administrative agent fees from Boxercraft (which were recognized by Prospect as other income). On August 25, 2014, Prospect sold Boxercraft, a wholly-owned subsidiary of BXC, for net proceeds of $750 and realized a net loss of $16,949 on the sale.

CCPI Inc.

Prospect owns 100% of the equity of CCPI Holdings Inc. (“CCPI Holdings”), a Consolidated Holding Company. CCPI Holdings owns 94.95% of the equity of CCPI Inc. (“CCPI”), with CCPI management owning the remaining 5.05% of the equity. CCPI owns 100% of each of CCPI Europe Ltd. and MEFEC B.V., and 45% of Gulf Temperature Sensors W.L.L.

On December 13, 2012, Prospect initially made a $15,921 investment (including 467,928 common shares of Prospect at fair value of $5,021) in CCPI Holdings, $7,500 senior secured note and $8,443 equity interest. The proceeds received by CCPI Holdings were partially utilized to purchase 95.13% of CCPI common stock for $14,878. The remaining proceeds were used to pay $395 of structuring fees from CCPI Holdings to Prospect (which were recognized by Prospect as structuring fee income), $215 for legal services provided by attorneys at Prospect Administration, $137 for third party expenses and $318 was retained by CCPI Holdings for working capital.

On December 13, 2012, Prospect made an additional investment of $18,000 in CCPI senior secured debt. The proceeds of the Prospect loan along with $14,878 of equity financing from CCPI Holdings (mentioned above) were used to purchase 95.13% of CCPI equity from the sellers for $31,829, provide $120 of debt financing to CCPI management (to partially fund a purchase by management of CCPI stock), fund $180 of structuring fees from CCPI to Prospect (which were recognized by Prospect as structuring fee income), pay $548 of third-party expenses, reimburse $12 for reimbursement of expenses paid by Prospect on behalf of CCPI (no income was recognized by Prospect) and $189 was retained by CCPI as working capital.

During the year ended June 30, 2014, certain members of CCPI management exercised options to purchase common stock, decreasing our ownership to 94.77%. On June 13, 2014, Prospect made a new $8,218 senior secured note to CCPI. CCPI then distributed this amount to CCPI Holdings as a return of capital which was used to pay down the $8,216 senior secured note from CCPI Holdings to Prospect. The remaining $2 was distributed to Prospect as a return of capital of Prospect’s equity investment in CCPI Holdings.

On July 1, 2014, Prospect began consolidating CCPI Holdings. As a result, any transactions between CCPI Holdings and Prospect are eliminated in consolidation and as such, transactions after July 1, 2014 are not presented below.

During the year ended June 30, 2015, CCPI repurchased 30 shares of its common stock from a former CCPI executive, decreasing the number of shares outstanding and increasing Prospect’s ownership to 94.95%.

In June 2015, CCPI engaged Prospect to provide certain investment banking and financial advisory services in connection with a possible transaction. As compensation for the services provided, Prospect received $525 of advisory fees from CCPI which was recognized as other income during the year ended June 30, 2015.

In addition to the repayments noted above, the following amounts were paid from CCPI to Prospect and recorded by Prospect as repayment of loan receivable:

Year Ended June 30, 2013	$338
Year Ended June 30, 2014	450
Year Ended June 30, 2015	450

The following dividends were declared and paid from CCPI to CCPI Holdings and recognized as dividend income by CCPI Holdings:

Year Ended June 30, 2013	$794
Year Ended June 30, 2014	1,266
Year Ended June 30, 2015	—

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The following dividends were declared and paid from CCPI Holdings to Prospect and recognized as dividend income by Prospect:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	500
Year Ended June 30, 2015	N/A

All dividends were paid from earnings and profits of CCPI and CCPI Holdings.

The following interest payments were accrued and paid from CCPI Holdings to Prospect and recognized by Prospect as interest income:

Year Ended June 30, 2013	$801
Year Ended June 30, 2014	1,464
Year Ended June 30, 2015	N/A

Included above, the following payment-in-kind interest from CCPI Holdings was capitalized and recognized by Prospect as interest income:

Year Ended June 30, 2013	$159
Year Ended June 30, 2014	557
Year Ended June 30, 2015	N/A

The following interest payments were accrued and paid from CCPI to Prospect and recognized by Prospect as interest income:

Year Ended June 30, 2013	$991
Year Ended June 30, 2014	1,848
Year Ended June 30, 2015	3,332

Included above, the following payment-in-kind interest from CCPI was capitalized and recognized by Prospect as interest income:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	27
Year Ended June 30, 2015	599

The following interest income recognized had not yet been paid by CCPI to Prospect and was included by Prospect within interest receivable:

June 30, 2014	$9
June 30, 2015	—

The following royalty payments were paid from CCPI Holdings to Prospect and recognized by Prospect as other income:

Year Ended June 30, 2013	$32
Year Ended June 30, 2014	71
Year Ended June 30, 2015	N/A

The following managerial assistance payments were paid from CCPI to Prospect and subsequently remitted to Prospect Administration (no income was recognized by Prospect):

Year Ended June 30, 2013	$132
Year Ended June 30, 2014	240
Year Ended June 30, 2015	240

The following managerial assistance payments received by Prospect had not yet been remitted to Prospect Administration and were included by Prospect within due to Prospect Administration:
June 30, 2014 $60
June 30, 2015 60
The following payments were paid from CCPI to Prospect Administration as reimbursement for legal, tax and portfolio level accounting services provided directly to CCPI (no direct income was recognized by Prospect, but Prospect was given credit for these payments as a reduction of the administrative services costs payable by Prospect to Prospect Administration):
Year Ended June 30, 2013 $214
Year Ended June 30, 2014 249
Year Ended June 30, 2015 —
The following amounts were due from CCPI to Prospect for reimbursement of expenses paid by Prospect on behalf of CCPI and were included by Prospect within other receivables:
June 30, 2014 $10
June 30, 2015 —
CP Energy Services Inc.
Prospect owns 100% of the equity of CP Holdings of Delaware LLC (“CP Holdings”), a Consolidated Holding Company. CP Holdings owns 82.3% of the equity of CP Energy Services Inc. (“CP Energy”), and the remaining 17.7% of the equity is owned by CP Energy management. As of June 30, 2014, CP Energy owned directly or indirectly 100% of each of CP Well Testing Services, LLC (f/k/a CP Well Testing Holding Company LLC) (“CP Well Testing”); CP Well Testing, LLC (“CP Well”); Fluid Management Services, Inc. (f/k/a Fluid Management Holdings, Inc.) (“Fluid Management”); Fluid Management Services LLC (f/k/a Fluid Management Holdings LLC); Wright Transport, Inc. (f/k/a Wright Holdings, Inc.); Wright Foster Disposals, LLC; Foster Testing Co., Inc.; ProHaul Transports, LLC; Artexoma Logistics, LLC; and Wright Trucking, Inc. Effective December 31, 2014, CP Energy underwent a corporate reorganization in order to consolidate certain of its wholly-owned subsidiaries. As of June 30, 2015, CP Energy owned directly or indirectly 100% of each of CP Well; Wright Foster Disposals, LLC; Foster Testing Co., Inc.; ProHaul Transports, LLC; and Wright Trucking, Inc. CP Energy provides oilfield flowback services and fluid hauling and disposal services through its subsidiaries.
On October 3, 2012, Prospect initially made a $21,500 senior secured debt investment in CP Well. As part of the transaction, Prospect received $430 of structuring fees from CP Well (which was recognized by Prospect as structuring fee income) and $7 was paid by CP Well to Prospect Administration for legal services provided by attorneys at Prospect Administration.
On August 2, 2013, Prospect invested $94,014 (including 1,918,342 unregistered shares of Prospect common stock at a fair value of $21,006) to support the recapitalization of CP Energy where Prospect acquired a controlling interest in CP Energy.
On August 2, 2013, Prospect invested $12,741 into CP Holdings to purchase 100% of the common stock in CP Holdings. The proceeds were used by CP Holdings to purchase 82.9% of the common stock in CP Energy for $12,135 and pay $606 of legal services provided by attorneys at Prospect Administration.
On August 2, 2013, Prospect made a senior secured debt investment of $58,773 in CP Energy. CP Energy also received $2,505 management co-investment in exchange for 17.1% of CP Energy common stock. Total proceeds received by CP Energy of $73,413 (including the $12,135 of equity financing from CP Holdings mentioned above) were used to purchase 100% of the equity interests in CP Well Testing and Fluid Management for $33,600 and $34,576, respectively. The remaining proceeds were used by CP Energy to pay $1,414 of structuring fees to Prospect (which was recognized by Prospect as structuring fee income) and pay $823 of third-party expenses, with $3,000 retained by CP Energy for working capital.
On August 2, 2013, Prospect made an additional senior secured debt investment of $22,500 in CP Well Testing. Total proceeds received by CP Well Testing of $56,100 (including the $33,600 of equity financing from CP Energy mentioned above) were used to purchase 100% of the equity interests in CP Well for $55,650 and pay $450 of structuring fees to Prospect (which was recognized by Prospect as structuring fee income). After the financing, Prospect received repayment of the $18,991 loan previously outstanding from CP Well.

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On October 11, 2013, Prospect made a $746 follow-on investment in CP Holdings to fund equity into CP Energy and made an additional senior secured loan to CP Energy of $5,100. Management invested an additional $154 of equity in CP Energy, and the percentage ownership of CP Energy did not change. Total proceeds of $6,000 were used to purchase flowback equipment and expand the CP Well operations in West Texas.

On December 26, 2013, Prospect made an additional $1,741 follow-on investment in CP Holdings to fund equity into CP Energy and made an additional senior secured loan to CP Energy of $11,900. Management invested an additional $359 of equity in CP Energy, and the percentage ownership of CP Energy did not change. Total proceeds of $14,000 were used to purchase additional equipment.

On April 1, 2014, Prospect made new loans to CP Well (with Foster Testing Co., Inc.; ProHaul Transports, LLC; and Wright Trucking, Inc. as co-borrowers), two first lien loans in the amount of $11,035 and $72,238, and a second lien loan in the amount of $15,000. The proceeds of these loans were used to repay CP Energy's senior secured term loan and CP Well Testing's senior secured term loan previously outstanding from Prospect.

On July 1, 2014, Prospect began consolidating CP Holdings. As a result, any transactions between CP Holdings and Prospect are eliminated in consolidation and as such, transactions after July 1, 2014 are not presented below.

During the year ended June 30, 2015, certain members of CP Energy management exercised options to purchase common stock, decreasing our ownership to 82.3%.

The following interest payments were accrued and paid from CP Energy to Prospect and recognized by Prospect as interest income:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	8,083
Year Ended June 30, 2015	—

The following interest payments were accrued and paid from CP Well Testing to Prospect and recognized by Prospect as interest income:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	1,657
Year Ended June 30, 2015	—

The following interest payments were accrued and paid from CP Well to Prospect and recognized by Prospect as interest income:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	4,118
Year Ended June 30, 2015	16,420

Included above, the following payment-in-kind interest from CP Well was capitalized and recognized by Prospect as interest income:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	—
Year Ended June 30, 2015	2,818

The following interest income recognized had not yet been paid by CP Well to Prospect and was included by Prospect within interest receivable:

June 30, 2014	$45
June 30, 2015	46

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The following managerial assistance payments were paid from CP Energy to Prospect and subsequently remitted to Prospect Administration (no income was recognized by Prospect):
Year Ended June 30, 2013 $ —
Year Ended June 30, 2014 275
Year Ended June 30, 2015 300
The following managerial assistance payments received by Prospect had not yet been remitted to Prospect Administration and were included by Prospect within due to Prospect Administration:
June 30, 2014 $75
June 30, 2015 75
The following payments were paid from CP Energy to Prospect Administration as reimbursement for legal, tax and portfolio level accounting services provided directly to CP Energy (no direct income was recognized by Prospect, but Prospect was given credit for these payments as a reduction of the administrative services costs payable to Prospect Administration):
Year Ended June 30, 2013 $ —
Year Ended June 30, 2014 609
Year Ended June 30, 2015 60
The following amounts were due from CP Energy to Prospect for reimbursement of expenses paid by Prospect on behalf of CP Energy and were included by Prospect within other receivables:
June 30, 2014 $4
June 30, 2015 1
Credit Central Loan Company, LLC
Prospect owns 100% of the equity of Credit Central Holdings of Delaware, LLC (“Credit Central Delaware”), a Consolidated Holding Company. Credit Central Delaware owns 74.93% of the equity of Credit Central Loan Company, LLC (f/k/a Credit Central Holdings, LLC) (“Credit Central”), with entities owned by Credit Central management owning the remaining 25.07% of the equity. Credit Central owns 100% of each of Credit Central, LLC; Credit Central South, LLC; Credit Central of Texas, LLC; and Credit Central of Tennessee, LLC. Credit Central is a branch-based provider of installment loans.
On December 28, 2012, Prospect initially made a $47,663 investment (including the fair value of 897,906 common shares of Prospect for $9,581 on that date, which were included in the purchase cost paid to acquire Credit Central) in Credit Central Delaware, of which $38,082 was a Senior Secured Revolving Credit Facility and $9,581 to purchase the membership interests of Credit Central Delaware. The proceeds were partially utilized to purchase 74.75% of Credit Central’s membership interests for $43,293. The remaining proceeds were used to pay $1,440 of structuring fees from Credit Central Delaware to Prospect (which was recognized by Prospect as structuring fee income), $638 for third party expenses, $292 for legal services provided by attorneys at Prospect Administration and $2,000 was retained by Credit Central Delaware for working capital. On March 28, 2014, Prospect funded an additional $2,500 ($2,125 to the Senior Secured Revolving Credit Facility and $375 to purchase additional membership interests of Credit Central Delaware) which was utilized by Credit Central Delaware to pay a $2,000 dividend to Prospect and $500 was retained by Credit Central Delaware for working capital.
On June 26, 2014, Prospect made a new $36,333 second lien term loan to Credit Central. Credit Central then distributed this amount to Credit Central Delaware as a return of capital which was used to pay down the Senior Secured Revolving Credit Facility from Credit Central Delaware by the same amount. The remaining amount of the Senior Secured Revolving Credit Facility, $3,874, was then converted to additional membership interests in Credit Central Delaware.
On July 1, 2014, Prospect began consolidating Credit Central Delaware. As a result, any transactions between Credit Central Delaware and Prospect are eliminated in consolidation and as such, transactions after July 1, 2014 are not presented below.
During the year ended June 30, 2015, Credit Central redeemed 24,629 shares of its membership interest from former Credit Central employees, decreasing the number of shares outstanding and increasing Prospect’s ownership to 74.93%.

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In addition to the repayments noted above, the following amounts were paid from Credit Central to Prospect and recorded by Prospect as repayment of loan receivable:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	—
Year Ended June 30, 2015	300

The following dividends were declared and paid from Credit Central to Credit Central Delaware and recognized as dividend income by Credit Central Delaware:

Year Ended June 30, 2013	$4,796
Year Ended June 30, 2014	10,431
Year Ended June 30, 2015	—

The following dividends were declared and paid from Credit Central Delaware to Prospect and recognized as dividend income by Prospect:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	4,841
Year Ended June 30, 2015	N/A

During the year ended June 30, 2015, Prospect reclassified $159 of return of capital received from Credit Central Delaware in the year ended June 30, 2014 as dividend income.

All dividends were paid from earnings and profits of Credit Central and Credit Central Delaware.

The following interest payments were accrued and paid from Credit Central Delaware to Prospect and recognized by Prospect as interest income:

Year Ended June 30, 2013	$3,893
Year Ended June 30, 2014	7,744
Year Ended June 30, 2015	N/A

The following interest payments were accrued and paid from Credit Central to Prospect and recognized by Prospect as interest income:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	101
Year Ended June 30, 2015	7,375

Included above, the following payment-in-kind interest from Credit Central was capitalized and recognized by Prospect as interest income:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	—
Year Ended June 30, 2015	300

The following interest income recognized had not yet been paid by Credit Central to Prospect and was included by Prospect within interest receivable:

June 30, 2014	$20
June 30, 2015	20

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The following royalty payments were paid from Credit Central Delaware to Prospect and recognized by Prospect as other income:

Year Ended June 30, 2013	$240
Year Ended June 30, 2014	521
Year Ended June 30, 2015	N/A

The following royalty payments were paid from Credit Central to Prospect and recognized by Prospect as other income:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	—
Year Ended June 30, 2015	1,220

The following managerial assistance payments were paid from Credit Central to Prospect and subsequently remitted to Prospect Administration (no income was recognized by Prospect):

Year Ended June 30, 2013	$350
Year Ended June 30, 2014	700
Year Ended June 30, 2015	700

The following managerial assistance payments received by Prospect had not yet been remitted to Prospect Administration and were included by Prospect within due to Prospect Administration:

June 30, 2014	$175
June 30, 2015	175

The following payments were paid from Credit Central to Prospect Administration as reimbursement for legal, tax and portfolio level accounting services provided directly to Credit Central (no direct income was recognized by Prospect, but Prospect was given credit for these payments as a reduction of the administrative services costs payable to Prospect Administration):

Year Ended June 30, 2013	$292
Year Ended June 30, 2014	131
Year Ended June 30, 2015	—

The following amounts were due to Credit Central from Prospect for reimbursement of expenses paid by Credit Central on behalf of Prospect and were included by Prospect within other liabilities:

June 30, 2014	$38
June 30, 2015	27

Echelon Aviation LLC

Prospect owns 99.02% of the membership interests of Echelon Aviation LLC (“Echelon”). Echelon owns 60.7% of the equity of AerLift Leasing Limited (“AerLift”).

On March 31, 2014, Prospect initially made a $92,628 investment in Echelon, of which $78,521 was a Senior Secured Revolving Credit Facility and $14,107 to purchase 100% of the membership interests of Echelon. The proceeds were partially utilized to purchase 60.7% of AerLift’s membership interests for $83,657. The remaining proceeds were used to pay $2,771 of structuring fees from Echelon to Prospect (which was recognized by Prospect as structuring fee income), $540 for third party expenses, $664 for legal and tax services provided by Prospect Administration and $4,996 was retained by Echelon for working capital.

During the year ended June 30, 2014, Echelon issued 57,779.44 Class B shares to the company’s President, decreasing Prospect’s ownership to 99.49%.

On July 1, 2014, Prospect sold a $400 participation in the Senior Secured Revolving Credit Facility, equal to 0.51% of the outstanding principal amount on that date.

On September 15, 2014, Echelon made an optional partial prepayment of $37,313 of the Senior Secured Revolving Credit Facility outstanding.

On September 30, 2014, Prospect made an additional $5,800 investment in the membership interests of Echelon. During the year ended June 30, 2015, Echelon issued 54,482.06 Class B shares to the company's President, decreasing Prospect's ownership to 99.02%.

The following interest payments were accrued and paid from Echelon to Prospect and recognized by Prospect as interest income:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	2,809
Year Ended June 30, 2015	6,895

The following interest income recognized had not yet been paid by Echelon to Prospect and was included by Prospect within interest receivable:

June 30, 2014	$2,809
June 30, 2015	2,412

The following managerial assistance payments were paid from Echelon to Prospect and subsequently remitted to Prospect Administration (no income was recognized by Prospect):

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	—
Year Ended June 30, 2015	313

The following managerial assistance payments received by Prospect had not yet been remitted to Prospect Administration and were included by Prospect within due to Prospect Administration:

June 30, 2014	$ —
June 30, 2015	63

The following managerial assistance recognized had not yet been paid by Echelon to Prospect and was included by Prospect within other receivables and due to Prospect Administration:

June 30, 2014	$63
June 30, 2015	—

The following payments were paid from Echelon to Prospect Administration as reimbursement for legal, tax and portfolio level accounting services provided directly to Echelon (no direct income was recognized by Prospect, but Prospect was given credit for these payments as a reduction of the administrative services costs payable by Prospect to Prospect Administration):

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	664
Year Ended June 30, 2015	211

The following amounts were due from Echelon to Prospect for reimbursement of expenses paid by Prospect on behalf of Echelon and were included by Prospect within other receivables:

June 30, 2014	$78
June 30, 2015	30

Edmentum Ultimate Holdings, LLC

Prospect owns 37.1% of the equity of Edmentum Ultimate Holdings, LLC ("Edmentum Holdings"). Edmentum Holdings owns 100% of the equity of Edmentum, Inc. ("Edmentum"). Edmentum is the largest all subscription based, software as a service provider of online curriculum and assessments to the U.S. education market. Edmentum provides high-value, comprehensive online solutions that support educators to successfully transition learners from one stage to the next.

On May 17, 2012, Prospect initially made a $50,000 second lien term loan to Edmentum.

On June 9, 2015, Prospect provided additional debt and equity financing to support the recapitalization of Edmentum. As part of the recapitalization, Prospect exchanged 100% of the $50,000 second lien term loan previously outstanding for $26,365 of junior PIK notes and 370,964.14 Class A common units representing 37.1% equity ownership in Edmentum Holdings. In addition, Prospect invested $5,875 in senior PIK notes and committed $7,834 as part of a second lien revolving credit facility, of which $4,896 was funded at closing. On June 9, 2015, we determined that the impairment of Edmentum was other-than-temporary and recorded a realized loss of $22,116 for the amount that the amortized cost exceeded the fair value, reducing the amortized cost to $37,216.

Energy Solutions Holdings Inc.

Prospect owns 100% of the equity of Energy Solutions Holdings Inc. (f/k/a Gas Solutions Holdings Inc.) (“Energy Solutions”), a Consolidated Holding Company. Energy Solutions owns 100% of each of Change Clean Energy Company, LLC (f/k/a Change Clean Energy Holdings, LLC) (“Change Clean”); Freedom Marine Solutions, LLC (f/k/a Freedom Marine Services Holdings, LLC) (“Freedom Marine”); and Yatesville Coal Company, LLC (f/k/a Yatesville Coal Holdings, LLC) (“Yatesville”). Change Clean owns 100% of each of Change Clean Energy, LLC and Down East Power Company, LLC, and 50.1% of BioChips LLC. Freedom Marine owns 100% of each of Vessel Company, LLC (f/k/a Vessel Holdings, LLC) (“Vessel”); Vessel Company II, LLC (f/k/a Vessel Holdings II, LLC) (“Vessel II”); and Vessel Company III, LLC (f/k/a Vessel Holdings III, LLC) (“Vessel III”). Yatesville owns 100% of North Fork Collieries, LLC.

Energy Solutions owns interests in companies operating in the energy sector. These include companies operating offshore supply vessels, ownership of a non-operating biomass electrical generation plant and several coal mines. Energy Solutions subsidiaries formerly owned interests in gathering and processing business in east Texas. As of July 1, 2011, the cost basis of Prospect’s investment in Energy Solutions, including debt and equity, was $42,003.

In December 2011, Prospect completed a reorganization of Gas Solutions Holdings Inc. renaming the company Energy Solutions and transferring ownership of other operating companies owned by Prospect and operating within the energy industry. As part of the reorganization, Prospect transferred its debt and equity interests with cost basis of $2,540 in Change Clean Energy Holdings, Inc. and Change Clean Energy, Inc. to Change Clean; $12,504 in Freedom Marine Holdings, Inc. to Freedom Marine; and $1,449 of Yatesville Coal Holdings, Inc. to Yatesville. Each of these entities is wholly owned (directly or indirectly) by Energy Solutions. On December 28, 2011, Prospect made a follow-on $1,250 equity investment in Energy Solutions and a $3,500 debt investment in Vessel.

On January 4, 2012, Energy Solutions sold its gas gathering and processing assets held in Gas Solutions II Ltd. (“Gas Solutions”) for a potential sale price of $199,805, adjusted for the final working capital settlement, including a potential earn-out of $28,000 that may be paid based on the future performance of Gas Solutions. After expenses, including structuring fees of $9,966 paid to Prospect, and $3,152 of third-party expenses, Gas Solutions LP LLC and Gas Solutions GP LLC, subsidiaries of Gas Solutions, received $157,100 and $1,587 in cash, respectively, and subsequently distributed these amounts, $158,687 in total, to Energy Solutions. The sale of Gas Solutions by Energy Solutions resulted in significant earnings and profits, as defined by the Code, at Energy Solutions for calendar year 2012. In accordance with ASC 946, the distributions Prospect received from Energy Solutions during calendar year 2012 were required to be recognized as dividend income, as there were current year earnings and profits sufficient to support such recognition. As a result, we recognized dividends of $53,820 from Energy Solutions during the year ended June 30, 2013. No such dividends were received from Energy Solutions during the year ended June 30, 2014.

During the year ended June 30, 2013, Energy Solutions repaid $28,500 of senior and subordinated secured debt due to Prospect. In addition to the repayment of principal, Prospect received $19,543 of make-whole fees for early repayment of the outstanding loan receivables, which was recorded as additional interest income during the year ended June 30, 2013.

On November 25, 2013, Prospect restructured its investment in Freedom Marine. The $12,504 subordinated secured loan to Jettco Marine Services, LLC, a subsidiary of Freedom Marine, was replaced with a senior secured note to Vessel II. On December 3, 2013, Prospect made a $16,000 senior secured investment in Vessel III. Overall, the restructuring of Prospect’s investment in Freedom Marine provided approximately $16,000 net new senior secured debt financing to support the acquisition of two new vessels. Prospect received $2,480 of structuring fees from Energy Solutions related to the Freedom Marine restructuring which was recognized as other income.

During the year ended June 30, 2014, Energy Solutions repaid the remaining $8,500 of the subordinated secured debt due to Prospect. In addition to the repayment of principal, Prospect received $4,812 of make-whole fees for early repayment of the outstanding loan receivables, which was recorded as additional interest income during the year ended June 30, 2014.
On November 28, 2012 and January 1, 2014, Prospect received $475 and $25 of litigation settlement proceeds related to Change Clean and recorded a reduction in its equity investment cost basis for Energy Solutions, respectively.

On June 4, 2014, Gas Solutions GP LLC and Gas Solutions LP LLC merged with and into Freedom Marine, with Freedom Marine as the surviving entity.

On July 1, 2014, Prospect began consolidating Energy Solutions. As a result, any transactions between Energy Solutions and Prospect are eliminated in consolidation and as such, transactions after July 1, 2014 are not presented below. Transactions between Prospect and Freedom Marine are separately discussed below under “Freedom Marine Solutions, LLC.”

During the three months ended December 31, 2014, Prospect determined that the impairments of Change Clean and Yatesville were other-than-temporary and recorded a realized loss of $1,449, reducing the amortized cost to zero.

The following interest payments, including prepayment penalty fees, were accrued and paid from Energy Solutions to Prospect and recognized by Prospect as interest income:

Year Ended June 30, 2013	$24,172
Year Ended June 30, 2014	5,368
Year Ended June 30, 2015	N/A

The following managerial assistance payments were paid from Energy Solutions to Prospect and subsequently remitted to Prospect Administration (no income was recognized by Prospect):

Year Ended June 30, 2013	$180
Year Ended June 30, 2014	180
Year Ended June 30, 2015	N/A

The following managerial assistance payments received by Prospect had not yet been remitted to Prospect Administration and were included by Prospect within due to Prospect Administration:

June 30, 2014	$45
June 30, 2015	N/A

The following payments were paid from Energy Solutions to Prospect Administration as reimbursement for legal, tax and portfolio level accounting services provided directly to Energy Solutions (no direct income was recognized by Prospect, but Prospect was given credit for these payments as a reduction of the administrative services costs payable by Prospect to Prospect Administration):

Year Ended June 30, 2013	$118
Year Ended June 30, 2014	—
Year Ended June 30, 2015	N/A

First Tower Finance Company LLC

Prospect owns 100% of the equity of First Tower Holdings of Delaware LLC (“First Tower Delaware”), a Consolidated Holding Company. First Tower Delaware owns 80.1% of First Tower Finance Company LLC (f/k/a First Tower Holdings LLC) (“First Tower Finance”). First Tower Finance owns 100% of First Tower, LLC (“First Tower”), a multiline specialty finance company.

On June 15, 2012, Prospect made a $287,953 investment (including 14,518,207 common shares of Prospect at a fair value of $160,571) in First Tower Delaware, of which $244,760 was a Senior Secured Revolving Credit Facility and $43,193 of membership interest in First Tower Delaware. The proceeds were utilized by First Tower Delaware to purchase 80.1% of the membership interests in First Tower Finance for $282,968. The remaining proceeds at First Tower Delaware were used to pay $4,038 of structuring fees from First Tower Delaware to Prospect (which was recognized by Prospect as structuring fee income), $940 of legal services provided by attorneys at Prospect Administration, and $7 of third party expenses. Prospect received an additional $4,038 of structuring fees from First Tower (which was recognized by Prospect as structuring fee income). Management purchased the additional 19.9% of First Tower Finance common stock for $70,300. The combined proceeds received by First Tower Finance of $353,268 ($282,968 equity financing from First Tower Delaware mentioned above and $70,300 equity financing from management) were used to purchase 100% of the common stock of First Tower for $338,042, pay $11,188 of third-party expenses and $4,038 of structuring fees from First Tower mentioned above (which was recognized by Prospect as structuring fee income).

On October 18, 2012, Prospect made an additional $20,000 investment through the Senior Secured Revolving Credit Facility, $12,008 of which was invested by First Tower Delaware in First Tower Finance as equity and $7,992 of which was retained by First Tower Delaware as working capital. On December 30, 2013, Prospect funded an additional $10,000 into First Tower Delaware, $8,500 through the Senior Secured Revolving Credit Facility and $1,500 through the purchase of additional membership interests in First Tower Delaware. $8,000 of the proceeds were utilized by First Tower Delaware to pay structuring fees to Prospect for the renegotiation and expansion of First Tower's third-party revolver, and $2,000 of the proceeds were retained by First Tower Delaware for working capital. On June 24, 2014, Prospect made a new $251,246 second lien term loan to First Tower. First Tower distributed this amount to First Tower Finance, which distributed this amount to First Tower Delaware as a return of capital. First Tower Delaware used the distribution to partially pay down the Senior Secured Revolving Credit Facility. The remaining $23,712 of the Senior Secured Revolving Credit Facility was then converted to additional membership interests held by Prospect in First Tower Delaware.

On July 1, 2014, Prospect began consolidating First Tower Delaware. As a result, any transactions between First Tower Delaware and Prospect are eliminated in consolidation and as such, transactions after July 1, 2014 are not presented below.

The following cash distributions were declared and paid from First Tower Finance to First Tower Delaware and recognized as a return of capital by First Tower Delaware:

Year Ended June 30, 2013	$31,918
Year Ended June 30, 2014	14,912
Year Ended June 30, 2015	—

The following dividends were declared and paid from First Tower Finance to First Tower Delaware and recognized as dividend income by First Tower Delaware:

Year Ended June 30, 2013	$54,035
Year Ended June 30, 2014	36,064
Year Ended June 30, 2015	—

During the year ended June 30, 2015, Prospect reclassified $1,929 of return of capital received from First Tower Finance in prior periods as dividend income.

All dividends were paid from earnings and profits of First Tower Finance.

The following interest payments were accrued and paid from First Tower Delaware to Prospect and recognized by Prospect as interest income:

Year Ended June 30, 2013	$52,476
Year Ended June 30, 2014	53,489
Year Ended June 30, 2015	N/A

Included above, the following payment-in-kind interest from First Tower Delaware was capitalized and recognized by Prospect as interest income:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	1,698
Year Ended June 30, 2015	N/A

The following interest payments were accrued and paid from First Tower to Prospect and recognized by Prospect as interest income:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	831
Year Ended June 30, 2015	52,900

Included above, the following payment-in-kind interest from First Tower was capitalized and recognized by Prospect as interest income:

Year Ended June 30, 2013 $ —
Year Ended June 30, 2014 —
Year Ended June 30, 2015 332

The following interest income recognized had not yet been paid by First Tower to Prospect and was included by Prospect within interest receivable:

June 30, 2014 $119
June 30, 2015 4,612

The following royalty payments were paid from First Tower Delaware to Prospect and recognized by Prospect as other income:

Year Ended June 30, 2013 $2,426
Year Ended June 30, 2014 2,560
Year Ended June 30, 2015 N/A

The following managerial assistance payments were paid from First Tower Delaware to Prospect and subsequently remitted to Prospect Administration (no income was recognized by Prospect):

Year Ended June 30, 2013 $2,520
Year Ended June 30, 2014 2,400
Year Ended June 30, 2015 N/A

At June 30, 2014, $600 of managerial assistance received by Prospect had not yet been remitted to Prospect Administration and was included by Prospect within due to Prospect Administration.

The following managerial assistance payments were accrued and paid from First Tower Delaware to Prospect Administration and recognized by Prospect as an expense:

Year Ended June 30, 2013 $ —
Year Ended June 30, 2014 —
Year Ended June 30, 2015 2,400

At June 30, 2015, $600 of managerial assistance recognized had not yet been paid by First Tower Delaware to Prospect Administration and was included by Prospect within due to Prospect Administration.

The following payments were paid from First Tower Delaware to Prospect Administration as reimbursement for legal, tax and portfolio level accounting services provided directly to First Tower Delaware (no direct income was recognized by Prospect, but Prospect was given credit for these payments as a reduction of the administrative services costs payable by Prospect to Prospect Administration):

Year Ended June 30, 2013 $ 4
Year Ended June 30, 2014 243
Year Ended June 30, 2015 N/A

The following amounts were due from First Tower to Prospect for reimbursement of expenses paid by Prospect on behalf of First Tower and were included by Prospect within other receivables:

June 30, 2014 $37
June 30, 2015 20

Freedom Marine Solutions, LLC

As discussed above, Prospect owns 100% of the equity of Energy Solutions, a Consolidated Holding Company. Energy Solutions owns 100% of Freedom Marine. Freedom Marine owns 100% of each of Vessel, Vessel II, and Vessel III.

As of July 1, 2014, the cost basis of Prospect's total debt and equity investment in Freedom Marine was $39,811, which consisted of the following: $3,500 senior secured note to Vessel; $12,504 senior secured note to Vessel II; $16,000 senior secured note to Vessel III; and $7,807 of equity.

On December 29, 2014, Freedom Marine reached a settlement for and received $5,174, net of third party obligations, related to the contingent earn-out from the sale of Gas Solutions in January 2012 which was retained by Freedom Marine. This is a final settlement and no further payments are expected from the sale. (See "Energy Solutions Holdings Inc." above for more information related to the sale of Gas Solutions.)

The following interest payments were accrued and paid from Vessel to Prospect and recognized by Prospect as interest income:

Year Ended June 30, 2013	$637
Year Ended June 30, 2014	641
Year Ended June 30, 2015	639

The following interest income recognized had not yet been paid by Vessel to Prospect and was included by Prospect within interest receivable:

June 30, 2014	$2
June 30, 2015	2

The following interest payments were accrued and paid from Vessel II to Prospect and recognized by Prospect as interest income:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	1,023
Year Ended June 30, 2015	1,713

The following interest income recognized had not yet been paid by Vessel II to Prospect and was included by Prospect within interest receivable:

June 30, 2014	$5
June 30, 2015	5

The following interest payments were accrued and paid from Vessel III to Prospect and recognized by Prospect as interest income:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	1,213
Year Ended June 30, 2015	2,109

The following interest income recognized had not yet been paid by Vessel III to Prospect and was included by Prospect within interest receivable:

June 30, 2014	$6
June 30, 2015	6

The following managerial assistance payments were paid from Freedom Marine to Prospect and subsequently remitted to Prospect Administration (no income was recognized by Prospect):

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	—
Year Ended June 30, 2015	300

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The following managerial assistance payments received by Prospect had not yet been remitted to Prospect Administration and were included by Prospect within due to Prospect Administration:
June 30, 2014 $ —
June 30, 2015 75
The following payments were paid from Freedom Marine to Prospect Administration as reimbursement for legal, tax and portfolio level accounting services provided directly to Freedom Marine (no direct income was recognized by Prospect, but Prospect was given credit for these payments as a reduction of the administrative services costs payable by Prospect to Prospect Administration):
Year Ended June 30, 2013 $ 1
Year Ended June 30, 2014 38
Year Ended June 30, 2015 115
The following amounts were due from Freedom Marine to Prospect for reimbursement of expenses paid by Prospect on behalf of Freedom Marine and were included by Prospect within other receivables:
June 30, 2014 $1
June 30, 2015 3
Gulf Coast Machine & Supply Company
Prospect owns 100% of the preferred equity of Gulf Coast Machine & Supply Company ("Gulf Coast"). Gulf Coast is a provider of value-added forging solutions to energy and industrial end markets.
On October 12, 2012, Prospect initially made a $42,000 first lien term loan to Gulf Coast, of which $840 was used to pay structuring fees from Gulf Coast to Prospect (which was recognized by Prospect as structuring fee income). During the year ended June 30, 2013, Gulf Coast repaid $787 of the first lien term loan.
Between July 1, 2013 and November 8, 2013, Gulf Coast repaid $263 of the first lien term loan, leaving a balance of $40,950. On November 8, 2013, Gulf Coast issued $25,950 of convertible preferred stock to Prospect (representing 99.9% of the voting securities of Gulf Coast) in exchange for crediting the same amount to the first lien term loan previously outstanding, leaving a first lien loan balance of $15,000. Prior to this conversion, Prospect was just a lender to Gulf Coast and the investment was not a controlled investment. On November 29, 2013 and December 16, 2013, Prospect provided an additional $1,000 and $1,500, respectively, to fund working capital needs, increasing the first lien loan balance to $17,500.
During the year ended June 30, 2015, Prospect made an additional $8,500 investment in the first lien term loan to Gulf Coast to fund capital improvements to key forging equipment and other liquidity needs.
The following interest payments were accrued and paid from Gulf Coast to Prospect and recognized by Prospect as interest income:
Year Ended June 30, 2013 $ —
Year Ended June 30, 2014 1,449
Year Ended June 30, 2015 1,370
The following interest income recognized had not yet been paid by Gulf Coast to Prospect and was included by Prospect within interest receivable:
June 30, 2014 $6
June 30, 2015 —
The following amounts were due from Gulf Coast to Prospect for reimbursement of expenses paid by Prospect on behalf of Gulf Coast and were included by Prospect within other receivables:
June 30, 2014 $342
June 30, 2015 1

Harbortouch Payments, LLC

Prospect owns 100% of the equity of Harbortouch Holdings of Delaware Inc. (“Harbortouch Delaware”), a Consolidated Holding Company. Harbortouch Delaware owns 100% of the Class C voting units of Harbortouch Payments, LLC (“Harbortouch”), which provide for a 53.5% residual profits allocation. Harbortouch management owns 100% of the Class B and D voting units of Harbortouch, which provide for a 46.5% residual profits allocation. Harbortouch owns 100% of Credit Card Processing USA, LLC. Harbortouch is a provider of transaction processing services and point-of sale equipment used by merchants across the United States.

On March 31, 2014, Prospect made a $147,898 investment (including 2,306,294 common shares of Prospect at a fair value of $24,908) in Harbortouch Delaware. Of this amount, $123,000 was loaned in exchanged for a subordinated note and $24,898 was an equity contribution. Harbortouch Delaware utilized $137,972 to purchase 100% of the Harbortouch Class A voting preferred units which provided an 11% preferred return and a 53.5% interest in the residual profits. Harbortouch Delaware used the remaining proceeds to pay $4,920 of structuring fees to Prospect (which was recognized by Prospect as structuring fee income), $1,761 for legal services provided by attorneys at Prospect Administration and $3,245 was retained by Harbortouch Delaware for working capital. Additionally, on March 31, 2014, Prospect provided Harbortouch a senior secured loan of $130,796. Prospect received a structuring fee of $2,616 from Harbortouch (which was recognized by Prospect as structuring fee income).

On April 1, 2014, Prospect made a new $137,226 senior secured term loan to Harbortouch. Harbortouch then distributed this amount to Harbortouch Delaware as a return of capital which was used to pay down the $123,000 senior secured note from Harbortouch Delaware to Prospect. The remaining $14,226 was distributed to Prospect as a return of capital of Prospect’s equity investment in Harbortouch Delaware.

On July 1, 2014, Prospect began consolidating Harbortouch Delaware. As a result, any transactions between Harbortouch Delaware and Prospect are eliminated in consolidation and as such, transactions after July 1, 2014 are not presented below.

On September 30, 2014, Prospect made a new $26,431 senior secured term loan to Harbortouch to support an acquisition. As part of the transaction, Prospect received $529 of structuring fees (which was recognized by Prospect as structuring fee income) and $50 of amendment fees (which was recognized by Prospect as amendment fee income).

On December 19, 2014, Prospect made an additional $1,291 equity investment in Harbortouch Class C voting units. This amount was deferred consideration stipulated in the original agreement.

In addition to the repayments noted above, the following amounts were paid from Harbortouch to Prospect and recorded by Prospect as repayment of loan receivable:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	—
Year Ended June 30, 2015	5,371

The following cash distributions were declared and paid from Harbortouch to Harbortouch Holdings and recognized as a return of capital by Harbortouch Holdings:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	—
Year Ended June 30, 2015	55

The following interest payments were accrued and paid from Harbortouch Delaware to Prospect and recognized by Prospect as interest income:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	55
Year Ended June 30, 2015	N/A

The following interest payments were accrued and paid from Harbortouch to Prospect and recognized by Prospect as interest income:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	6,824
Year Ended June 30, 2015	29,834

Included above, the following payment-in-kind interest from Harbortouch was capitalized and recognized by Prospect as interest income:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	—
Year Ended June 30, 2015	7,652

The following interest income recognized had not yet been paid by Harbortouch to Prospect and was included by Prospect within interest receivable:

June 30, 2014	$1,962
June 30, 2015	2,077

The following managerial assistance payments were paid from Harbortouch to Prospect and subsequently remitted to Prospect Administration (no income was recognized by Prospect):

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	125
Year Ended June 30, 2015	500

The following managerial assistance payments received by Prospect had not yet been remitted to Prospect Administration and were included by Prospect within due to Prospect Administration:

June 30, 2014	$125
June 30, 2015	125

The following payments were paid from Harbortouch to Prospect Administration as reimbursement for legal, tax and portfolio level accounting services provided directly to Harbortouch (no direct income was recognized by Prospect, but Prospect was given credit for these payments as a reduction of the administrative services costs payable by Prospect to Prospect Administration):

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	1,761
Year Ended June 30, 2015	46

Manx Energy, Inc.

As of June 30, 2014, Prospect owned 41% of the equity of Manx Energy, Inc. (“Manx”). Manx was formed on January 19, 2010 for the purpose of rolling up the assets of existing Prospect portfolio companies, Coalbed, LLC (“Coalbed”), Appalachian Energy LLC (f/k/a Appalachian Energy Holdings, LLC) (“AEH”) and Kinley Exploration LLC. The three companies were combined under new common management.

On January 19, 2010, Prospect made a $2,800 investment at closing to Manx to provide for working capital. On the same date, Prospect exchanged $2,100 and $4,500 of the loans to AEH and Coalbed, respectively, for Manx preferred equity, and Prospect’s AEH equity interest was converted into Manx common stock. There was no change to fair value at the time of restructuring, and Prospect continued to fully reserve any income accrued for Manx. On October 15, 2010 and May 26, 2011, Prospect increased its loan to Manx in the amount of $500 and $250, respectively, to provide additional working capital. As of June 30, 2011, the cost basis of Prospect’s investment in Manx, including debt and equity, was $19,019.

On June 30, 2012, AEH and Coalbed loans held by Manx with a cost basis of $7,991 were removed from Manx and contributed by Prospect to Wolf Energy Holdings Inc., a separate holding company wholly owned by Prospect. During the three months ended June 30, 2013, Prospect determined that the impairment of Manx was other-than-temporary and recorded a realized loss of $9,397 for the amount that the amortized cost exceeded the fair value, reducing the amortized cost to $500. During the year ended June 30, 2014, Manx repaid $450 of the senior secured note. During the three months ended December 31, 2014, Manx was dissolved and Prospect recorded a realized loss of $50, reducing the amortized cost to zero.

MITY, Inc.

Prospect owns 100% of the equity of MITY Holdings of Delaware Inc. ("MITY Delaware"), a Consolidated Holding Company. MITY Delaware holds 94.99% of the equity of MITY, Inc. (f/k/a MITY Enterprises, Inc.) ("MITY"), with management of MITY owning the remaining 5.01% of the equity of MITY. MITY owns 100% of each of MITY-Lite, Inc. ("MITY-Lite"); Broda USA, Inc. (f/k/a Broda Enterprises USA, Inc.) ("Broda USA"); and Broda Enterprises ULC ("Broda Canada"). MITY is a designer, manufacturer and seller of multipurpose room furniture and specialty healthcare seating products.

On September 19, 2013, Prospect made a $29,735 investment in MITY Delaware, of which $22,792 was a senior secured debt to MITY Delaware and $6,943 was a capital contribution to the equity of MITY Delaware. The proceeds were partially utilized to purchase 97.7% of MITY common stock for $21,027. The remaining proceeds were used to issue a $7,200 note from Broda Canada to MITY Delaware, pay $684 of structuring fees from MITY Delaware to Prospect (which was recognized by Prospect as structuring fee income), $311 for legal services provided by attorneys employed by Prospect Administration and $513 was retained by MITY Delaware for working capital.

On September 19, 2013, Prospect made an additional $18,250 senior secured debt investment in MITY. The proceeds were used to repay existing third-party indebtedness, pay $365 of structuring fees from MITY to Prospect (which was recognized by Prospect as structuring fee income), pay $1,143 of third party expenses and $2,580 was retained by MITY for working capital. Members of management of MITY purchased additional shares of common stock of MITY, reducing MITY Delaware's ownership to 94.99%. MITY, MITY-Lite and Broda USA are joint borrowers on the senior secured debt of MITY.

On June 23, 2014, Prospect made a new $15,769 debt investment in MITY and MITY distributed proceeds to MITY Delaware as a return of capital. MITY Delaware used this distribution to pay down the senior secured debt of MITY Delaware to Prospect by the same amount. The remaining amount of the senior secured debt due from MITY Delaware to Prospect, $7,200, was then contributed to the capital of MITY Delaware. On June 23, 2014, Prospect also extended a new $7,500 senior secured revolving facility to MITY, which was unfunded at closing.

On July 1, 2014, Prospect began consolidating MITY Delaware. As a result, any transactions between MITY Delaware and Prospect are eliminated in consolidation and as such, transactions after July 1, 2014 are not presented below.

During the year ended June 30, 2015, Prospect funded $2,500 of MITY's senior secured revolving facility, which MITY fully repaid during that time.

The following cash distributions were declared and paid from MITY to MITY Delaware and recognized as a return of capital by MITY Delaware:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	884
Year Ended June 30, 2015	—

The following dividends were declared and paid from MITY to MITY Delaware and recognized as dividend income by MITY Delaware:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	861
Year Ended June 30, 2015	—

All dividends were paid from earnings and profits of MITY.

The following interest payments were accrued and paid from MITY Delaware to Prospect and recognized by Prospect as interest income:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	3,177
Year Ended June 30, 2015	N/A

Included above, the following payment-in-kind interest from MITY Delaware was capitalized and recognized by Prospect as interest income:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	177
Year Ended June 30, 2015	N/A

The following interest payments were accrued and paid from MITY to Prospect and recognized by Prospect as interest income:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	1,516
Year Ended June 30, 2015	5,146

Included above, the following payment-in-kind interest from MITY was capitalized and recognized by Prospect as interest income:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	—
Year Ended June 30, 2015	532

The following interest income recognized had not yet been paid by MITY to Prospect and was included by Prospect within interest receivable:

June 30, 2014	$14
June 30, 2015	14

The following interest payments were accrued and paid from Broda Canada to MITY Delaware and recognized by Prospect as interest income:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	—
Year Ended June 30, 2015	637

During the year ended June 30, 2015, there was an unfavorable fluctuation in the foreign currency exchange rate and MITY Delaware recognized $5 of realized loss related to its investment in Broda Canada.

The following managerial assistance payments were paid from MITY to Prospect and subsequently remitted to Prospect Administration (no income was recognized by Prospect):

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	225
Year Ended June 30, 2015	310

The following managerial assistance payments received by Prospect had not yet been remitted to Prospect Administration and were included by Prospect within due to Prospect Administration:

June 30, 2014	$75
June 30, 2015	75

The following managerial assistance recognized had not yet been paid by MITY to Prospect and was included by Prospect within other receivables and due to Prospect Administration:
June 30, 2014 $10
June 30, 2015 —
The following payments were paid from MITY to Prospect Administration as reimbursement for legal, tax and portfolio level accounting services provided directly to MITY (no direct income was recognized by Prospect, but Prospect was given credit for these payments as a reduction of the administrative services costs payable by Prospect to Prospect Administration):
Year Ended June 30, 2013 $ —
Year Ended June 30, 2014 495
Year Ended June 30, 2015 121
The following amounts were due to MITY from Prospect for reimbursement of expenses paid by MITY on behalf of Prospect and were included within other liabilities:
June 30, 2014 $5
June 30, 2015 1
National Property REIT Corp.
Prospect owns 100% of the equity of NPH Property Holdings, LLC (“NPH”), a Consolidated Holding Company. NPH owns 100% of the common equity of National Property REIT Corp. (f/k/a National Property Holdings Corp.) (“NPRC”). NPRC is a Maryland corporation and a qualified REIT for federal income tax purposes. In order to qualify as a REIT, NPRC issued 125 shares of Series A Cumulative Non-Voting Preferred Stock to 125 accredited investors. The preferred stockholders are entitled to receive cumulative dividends semi-annually at an annual rate of 12.5% and do not have the ability to participate in the management or operation of NPRC.
NPRC was formed to hold for investment, operate, finance, lease, manage, and sell a portfolio of real estate assets and engage in any and all other activities as may be necessary, incidental or convenient to carry out the foregoing. NPRC acquires real estate assets, including, but not limited to, industrial, commercial, and multi-family properties. NPRC may acquire real estate assets directly or through joint ventures by making a majority equity investment in a property-owning entity (the “JV”). Additionally, through its wholly-owned subsidiaries, NPRC invests in online consumer loans.
On December 31, 2013, APRC distributed its majority interests in five JVs holding real estate assets to APH. APH then distributed these JV interests to Prospect in a transaction characterized as a return of capital. Prospect, on the same day, contributed certain of these JV interests to NPH and the remainder to UPH (each wholly-owned subsidiaries of Prospect). Each of NPH and UPH immediately thereafter contributed these JV interests to NPRC and UPRC, respectively. The total investments in the JVs transferred to NPH and from NPH to NPRC consisted of $79,309 and $16,315 of debt and equity financing, respectively. There was no material gain or loss realized on these transactions.
On December 31, 2013, Prospect made a $10,620 investment in NPH, of which $8,800 was a Senior Term Loan and $1,820 was used to purchase additional membership interests of NPH. The proceeds were utilized by NPH to purchase additional NPRC common equity for $10,620. The proceeds were utilized by NPRC to purchase a 93.0% ownership interest in APH Carroll Bartram Park, LLC for $10,288 and to pay $113 of structuring fees to Prospect (which was recognized by Prospect as structuring fee income), with $219 retained by NPRC for working capital. The JV was purchased for $38,000 which included debt financing and minority interest of $28,500 and $774, respectively. The remaining proceeds were used to pay $206 of structuring fees to Prospect (which was recognized by Prospect as structuring fee income), $1,038 of third party expenses, $5 of legal services provided by attorneys at Prospect Administration, and $304 of prepaid assets, with $9 retained by the JV for working capital.
Between January 7, 2014 and March 13, 2014, Prospect made a $14,000 investment in NPH, of which $11,900 was a Senior Term Loan and $2,100 was used to purchase additional membership interests of NPH. The proceeds were utilized by certain of NPRC’s wholly-owned subsidiaries to purchase online consumer loans from a third party.

On January 31, 2014, Prospect made a $4,805 investment in NPH, of which $4,000 was a Senior Term Loan and $805 used to purchase additional membership interests of NPH. The proceeds were utilized by NPH to purchase additional NPRC common equity for $4,805. The proceeds were utilized by NPRC to purchase a 93.0% ownership interest in APH Carroll Atlantic Beach, LLC for $4,603 and to pay $52 of structuring fees to Prospect (which was recognized by Prospect as structuring fee income), with $150 retained by NPRC for working capital. The JV was purchased for $13,025 which included debt financing and minority interest of $9,118 and $346, respectively. The remaining proceeds were used to pay $92 of structuring fees to Prospect (which was recognized by Prospect as structuring fee income), $681 of third party expenses, $7 of legal services provided by attorneys at Prospect Administration, and $182 of prepaid assets, with $80 retained by the JV for working capital.
Effective April 1, 2014, Prospect made a new $104,460 senior term loan to NPRC. NPRC then distributed this amount to NPH as a return of capital which was used to pay down the Senior Term Loan from NPH by the same amount.
Between April 3, 2014 and May 21, 2014, Prospect made an $11,000 investment in NPH and NPRC, of which $9,350 was a Senior Term Loan to NPRC and $1,650 was used to purchase additional membership interests of NPH. The proceeds were utilized by NPH to purchase additional NPRC common equity for $1,650. The proceeds were utilized by certain of NPRC's wholly-owned subsidiaries to purchase online consumer loans from a third party.
On July 1, 2014, Prospect began consolidating NPH. As a result, any transactions between NPH and Prospect are eliminated in consolidation and as such, transactions after July 1, 2014 are not presented below.
On October 23, 2014, UPRC transferred its investment in Michigan Storage, LLC to NPRC. As a result, Prospect's investments in UPRC related to these properties also transferred to NPRC. The investments transferred consisted of $1,281 of equity and $9,444 of debt. There was no gain or loss realized on the transaction.
On November 26, 2014, APRC transferred its investment in APH Carroll Resort, LLC to NPRC and the investment was renamed NPRC Carroll Resort, LLC. As a result, Prospect's investments in APRC related to this property also transferred to NPRC. The investments transferred consisted of $10,237 of equity and $65,586 of debt. There was no gain or loss realized on the transaction.
On January 16, 2015, Prospect made a $13,871 investment in NPRC, of which $11,810 was a Senior Term Loan directly to NPRC and $2,061 was used to purchase additional common equity of NPRC through NPH. The proceeds were utilized by NPRC to purchase additional ownership interest in Michigan Storage, LLC (which was originally purchased by UPRC and transferred to NPRC, as discussed below) for $13,854, with $17 retained by NPRC for working capital. The minority interest holder also invested an additional $2,445 in the JV. With additional debt financing of $12,602, the total proceeds were used by the JV to purchase five additional properties for $26,405. The remaining proceeds were used to pay $276 of structuring fees to Prospect (which was recognized by Prospect as structuring fee income), $1,762 of third party expenses, $65 in pre-funded capital expenditures, and $393 of prepaid assets.
On March 17, 2015, Prospect entered into a new credit agreement with ACL Loan Holdings, Inc. ("ACLLH"), a wholly-owned subsidiary of NPRC, to form two new tranches of senior secured term loans, Term Loan A and Term Loan B, with the same terms as the existing NPRC Term Loan A and Term Loan B due to Prospect. The agreement was effective as of June 30, 2014. On June 30, 2014, ACLLH made a non-cash return of capital distribution of $22,390 to NPRC and NPRC transferred and assigned to ACLLH a senior secured Term Loan A due to Prospect.
On May 1, 2015, APRC transferred its investment in 5100 Live Oaks Blvd, LLC to NPRC. As a result, Prospect's investments in APRC related to this property also transferred to NPRC. The investments transferred consisted of $2,748 of equity and $29,990 of debt. There was no gain or loss realized on the transaction.
On May 6, 2015, Prospect made a $252 investment in NPRC, of which $236 was a Senior Term Loan and $16 was used to purchase additional common equity of NPRC through NPH. The proceeds were utilized by NPRC to purchase additional ownership interest in 5100 Live Oaks Blvd, LLC for $252. The minority interest holder also invested an additional $6 in the JV. The proceeds were used by the JV to fund $258 of capital expenditures.
On June 2, 2015, Prospect amended the credit agreement with NPRC to form two new tranches of senior secured term loans, Term Loan C and Term Loan D, with the same terms as the existing ACLLH Term Loan A and Term Loan B due to Prospect. The amendment was effective as of April 1, 2015.
During the year ended June 30, 2015, Prospect made thirty-six follow-on investments in NPRC totaling $224,200 to support the online consumer lending initiative. Prospect invested $52,350 of equity through NPH and $171,850 of

debt directly to NPRC and its wholly-owned subsidiaries. In addition, during the year ended June 30, 2015, Prospect received partial repayments of $32,883 of the loans previously outstanding and $5,577 as a return of capital on the equity investment in NPRC.

The following dividends were declared and paid from NPRC to NPH (partially via a wholly-owned subsidiary of NPH) and recognized as dividend income by NPH:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	2,696
Year Ended June 30, 2015	—

All dividends were paid from earnings and profits of NPRC.

The following interest payments were accrued and paid by NPH to Prospect and recognized by Prospect as interest income:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	2,838
Year Ended June 30, 2015	N/A

Included above, the following payment-in-kind interest from NPH was capitalized and recognized by Prospect as interest income:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	432
Year Ended June 30, 2015	N/A

The following interest payments were accrued and paid by NPRC to Prospect and recognized by Prospect as interest income:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	3,135
Year Ended June 30, 2015	23,869

Included above, the following payment-in-kind interest from NPRC was capitalized and recognized by Prospect as interest income:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	18
Year Ended June 30, 2015	3,056

The following interest income recognized had not yet been paid by NPRC to Prospect and was included by Prospect within interest receivable:

June 30, 2014	$ —
June 30, 2015	116

The following interest payments were accrued and paid by ACLLH to Prospect and recognized by Prospect as interest income:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	—
Year Ended June 30, 2015	6,742

Included above, the following payment-in-kind interest from ACLLH was capitalized and recognized by Prospect as interest income:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	—
Year Ended June 30, 2015	816

The following interest income recognized had not yet been paid by ACLLH to Prospect and was included by Prospect within interest receivable:
June 30, 2014 $ —
June 30, 2015 23
The following royalty payments were paid from NPH to Prospect and recognized by Prospect as other income:
Year Ended June 30, 2013 $ —
Year Ended June 30, 2014 567
Year Ended June 30, 2015 N/A
The following royalty payments were paid from NPRC to Prospect and recognized by Prospect as other income:
Year Ended June 30, 2013 $ —
Year Ended June 30, 2014 —
Year Ended June 30, 2015 1,683
The following managerial assistance payments were paid from NPRC to Prospect and subsequently remitted to Prospect Administration (no income was recognized by Prospect):
Year Ended June 30, 2013 $ —
Year Ended June 30, 2014 255
Year Ended June 30, 2015 510
The following managerial assistance payments received by Prospect had not yet been remitted to Prospect Administration and were included by Prospect within due to Prospect Administration:
June 30, 2014 $128
June 30, 2015 128
The following payments were paid from NPRC to Prospect Administration as reimbursement for legal, tax and portfolio level accounting services provided directly to NPRC (no direct income was recognized by Prospect, but Prospect was given credit for these payments as a reduction of the administrative services costs payable by Prospect to Prospect Administration):
Year Ended June 30, 2013 $ —
Year Ended June 30, 2014 207
Year Ended June 30, 2015 1,164
The following amounts were due from NPRC to Prospect for reimbursement of expenses paid by Prospect on behalf of NPRC and included by Prospect within other receivables:
June 30, 2014 $13
June 30, 2015 108

Nationwide Acceptance LLC

Prospect owns 100% of the membership interests of Nationwide Acceptance Holdings LLC ("Nationwide Holdings"), a Consolidated Holding Company. Nationwide Holdings owns 93.79% of the equity of Nationwide Loan Company LLC (f/k/a Nationwide Acceptance LLC) ("Nationwide"), with members of Nationwide management owning the remaining 6.21% of the equity.

On January 31, 2013, Prospect initially made a $25,151 investment in Nationwide Holdings, of which $21,308 was a Senior Secured Revolving Credit Facility and $3,843 was in the form of membership interests in Nationwide Holdings. $21,885 of the proceeds were utilized to purchase 93.79% of the membership interests in Nationwide. Proceeds were also used to pay $753 of structuring fees from Nationwide Holdings to Prospect (which was recognized by Prospect as structuring fee income), $350 of third party expenses and $163 of legal services provided by attorneys at Prospect Administration. The remaining $2,000 was retained by Nationwide Holdings as working capital.

In December 2013, Prospect received $1,500 of structuring fees from Nationwide Holdings related to the amendment of the loan agreement. On March 28, 2014, Prospect funded an additional $4,000 to Nationwide Holdings ($3,400 through the Senior Secured Revolving Credit Facility and $600 to purchase additional membership interests in Nationwide Holdings). The additional funding along with cash on hand was utilized by Nationwide Holdings to fund a $5,000 dividend to Prospect.

On June 18, 2014, Prospect made a new $14,820 second lien term loan to Nationwide. Nationwide distributed this amount to Nationwide Holdings as a return of capital. Nationwide Holdings used the distribution to pay down the Senior Secured Revolving Credit Facility. The remaining $9,888 of the Senior Secured Revolving Credit Facility was then converted to additional membership interests in Nationwide Holdings.

On July 1, 2014, Prospect began consolidating Nationwide Holdings. As a result, any transactions between Nationwide Holdings and Prospect are eliminated in consolidation and as such, transactions after July 1, 2014 are not presented below.

On June 1, 2015, Nationwide completed a corporate reorganization. As part of the reorganization, Nationwide Acceptance LLC was renamed Nationwide Loan Company LLC (continues as "Nationwide") and formed two new wholly-owned subsidiaries: Pelican Loan Company LLC ("Pelican") and Nationwide Consumer Loans LLC. Nationwide assigned 100% of the equity interests in its other subsidiaries to Pelican which, in turn, assigned these interests to Nationwide Acceptance LLC ("New Nationwide"), the new operating company wholly-owned by Pelican. New Nationwide also assumed the existing senior subordinated term loan due to Prospect.

During the year ended June 30, 2015, Prospect made additional equity investments totaling $2,814 in Nationwide. Nationwide management invested an additional $186 of equity in Nationwide, and Prospect's ownership in Nationwide did not change.

The following dividends were declared and paid from Nationwide to Nationwide Holdings and recognized as dividend income by Nationwide Holdings:

Year Ended June 30, 2013	$2,615
Year Ended June 30, 2014	7,074
Year Ended June 30, 2015	4,425

The following dividends were declared and paid from Nationwide Holdings to Prospect and recognized as dividend income by Prospect:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	5,000
Year Ended June 30, 2015	N/A

All dividends were paid from earnings and profits of Nationwide and Nationwide Holdings.

The following interest payments were accrued and paid from Nationwide Holdings to Prospect and recognized by Prospect as interest income:

Year Ended June 30, 2013	$1,788
Year Ended June 30, 2014	4,322
Year Ended June 30, 2015	N/A

Explanation of Responses:

The following interest payments were accrued and paid from Nationwide to Prospect and recognized by Prospect as interest income:

Year Ended June 30, 2013 $ —
Year Ended June 30, 2014 107
Year Ended June 30, 2015 3,005

The following interest income recognized had not yet been paid by Nationwide to Prospect and was included by Prospect within interest receivable:

June 30, 2014 $8
June 30, 2015 8

The following royalty payments were paid from Nationwide Holdings to Prospect and recognized by Prospect as other income:

Year Ended June 30, 2013 $131
Year Ended June 30, 2014 354
Year Ended June 30, 2015 N/A

The following managerial assistance payments were paid from Nationwide to Prospect and subsequently remitted to Prospect Administration (no income was recognized by Prospect):

Year Ended June 30, 2013 $167
Year Ended June 30, 2014 400
Year Ended June 30, 2015 400

The following managerial assistance payments received by Prospect had not yet been remitted to Prospect Administration and were included by Prospect within due to Prospect Administration:

June 30, 2014 $100
June 30, 2015 100

The following payments were paid from Nationwide to Prospect Administration as reimbursement for legal, tax and portfolio level accounting services provided directly to Nationwide (no direct income was recognized by Prospect, but Prospect was given credit for these payments as a reduction of the administrative services costs payable by Prospect to Prospect Administration):

Year Ended June 30, 2013 $163
Year Ended June 30, 2014 234
Year Ended June 30, 2015 4

The following amounts were due from Nationwide to Prospect for reimbursement of expenses paid by Prospect on behalf of Nationwide and were included by Prospect within other receivables:

June 30, 2014 $2
June 30, 2015 —

The following amounts were due to Nationwide from Prospect for reimbursement of expenses paid by Nationwide on behalf of Prospect and were included by Prospect within other liabilities:

June 30, 2014 $ —
June 30, 2015 12

NMMB, Inc.

Prospect owns 100% of the equity of NMMB Holdings, Inc. (“NMMB Holdings”), a Consolidated Holding Company. NMMB Holdings owns 96.33% of the fully-diluted equity of NMMB, Inc. (f/k/a NMMB Acquisition, Inc.) (“NMMB”), with NMMB management owning the remaining 3.67% of the equity. NMMB owns 100% of Refuel Agency, Inc. (“Refuel Agency”). Refuel Agency owns 100% of Armed Forces Communications, Inc. (“Armed Forces”). NMMB is an advertising media buying business.

On May 6, 2011, Prospect initially made a $34,450 investment (of which $31,750 was funded at closing) in NMMB Holdings and NMMB, of which $24,250 was a senior secured term loan to NMMB, $3,000 was a senior secured revolver to NMMB (of which $300 was funded at closing), $2,800 was a senior subordinated term loan to NMMB Holdings and $4,400 to purchase 100% of the Series A Preferred Stock of NMMB Holdings. The proceeds received by NMMB were used to purchase 100% of the equity of Refuel Agency and assets related to the business for $30,069, pay $1,035 of structuring fees to Prospect (which was recognized by Prospect as structuring fee income), pay $396 for third party expenses and $250 was retained by NMMB for working capital. On May 31, 2011, NMMB repaid the $300 senior secured revolver.

During the year ended June 30, 2012, NMMB repaid $2,550 of the senior secured term loan. During the year ended June 30, 2013, NMMB repaid $5,700 of the senior secured term loan due.

On December 13, 2013, Prospect invested $8,086 for preferred equity to recapitalize NMMB Holdings. The proceeds were used by NMMB Holdings to repay in full the $2,800 outstanding under the subordinated term loan and the remaining $5,286 of proceeds from Prospect were used by NMMB Holdings to purchase preferred equity in NMMB. NMMB used the proceeds from the preferred equity issuance to pay down the senior term loan.

On June 12, 2014, Prospect made a new $7,000 senior secured term loan to Armed Forces. Armed Forces distributed this amount to Refuel Agency as a return of capital. Refuel Agency distributed this amount to NMMB as a return of capital, which was used to pay down $7,000 of NMMB’s $10,714 senior secured term loan to Prospect.

On July 1, 2014, Prospect began consolidating NMMB Holdings. As a result, any transactions between NMMB Holdings and Prospect are eliminated in consolidation and as such, transactions after July 1, 2014 are not presented below.

On October 1, 2014, Prospect made an additional $383 equity investment in NMMB Series B Preferred Stock, increasing Prospect’s ownership to 93.13%. During the year ended June 30, 2015, NMMB repurchased 460 shares of its common stock from a former NMMB executive, decreasing the number of shares outstanding and increasing Prospect’s ownership to 96.33%.

The following interest payments were accrued and paid from NMMB Holdings to Prospect and recognized by Prospect as interest income:

Year Ended June 30, 2013	$426
Year Ended June 30, 2014	192
Year Ended June 30, 2015	N/A

The following interest payments were accrued and paid from NMMB to Prospect and recognized by Prospect as interest income:

Year Ended June 30, 2013	$2,601
Year Ended June 30, 2014	1,826
Year Ended June 30, 2015	525

The following interest income recognized had not yet been paid by NMMB to Prospect and was included by Prospect within interest receivable:

June 30, 2014	$ 1
June 30, 2015	133

The following interest payments were accrued and paid from Armed Forces to Prospect and recognized by Prospect as interest income:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	33
Year Ended June 30, 2015	996

The following interest income recognized had not yet been paid by Armed Forces to Prospect and was included by Prospect within interest receivable:

June 30, 2014	$ 3
June 30, 2015	250

The following managerial assistance payments were paid from NMMB to Prospect and subsequently remitted to Prospect Administration (no income was recognized by Prospect):

Year Ended June 30, 2013	$500
Year Ended June 30, 2014	100
Year Ended June 30, 2015	—

The following managerial assistance recognized had not yet been paid by NMMB to Prospect and was included by Prospect within other receivables and due to Prospect Administration:

June 30, 2014	$300
June 30, 2015	700

The following payments were paid from NMMB to Prospect Administration as reimbursement for legal, tax and portfolio level accounting services provided directly to NMMB (no direct income was recognized by Prospect, but Prospect was given credit for these payments as a reduction of the administrative services costs payable by Prospect to Prospect Administration):

Year Ended June 30, 2013	$12
Year Ended June 30, 2014	15
Year Ended June 30, 2015	—

The following amounts were due from NMMB to Prospect for reimbursement of expenses paid by Prospect on behalf of NMMB and were included by Prospect within other receivables:

June 30, 2014	$1
June 30, 2015	2

R-V Industries, Inc.

As of July 1, 2011 and continuing through June 30, 2015, Prospect owns 88.27% of the fully-diluted equity of R-V Industries, Inc. (“R-V”), with R-V management owning the remaining 11.73% of the equity. As of June 30, 2011, Prospect’s equity investment cost basis was $1,682 and $5,087 for warrants and common stock, respectively.

On November 30, 2012, Prospect made a $9,500 second lien term loan to R-V and R-V received an additional $4,000 of senior secured financing from a third-party lender. The combined $13,500 of proceeds was partially utilized by R-V to pay a dividend to its common stockholders in an aggregate amount equal to $13,288 (including $11,073 to Prospect recognized by Prospect as a dividend). The remaining proceeds were used by R-V to pay $142 of structuring fees to Prospect (which was recognized by Prospect as structuring fee income), $47 for third party expenses and $23 for legal services provided by attorneys at Prospect Administration.

On June 12, 2013, Prospect provided an additional $23,250 to the second lien term loan to R-V. The proceeds were partially utilized by R-V to pay a dividend to the common stockholders in an aggregate amount equal to $15,000 (including $13,240 dividend to Prospect). The remaining proceeds were used to pay off $7,835 of outstanding debt due from R-V to a third-party, $11 for legal services provided by attorneys at Prospect Administration and $404 was retained by R-V for working capital.

In addition to the repayments noted above, the following amounts were paid from R-V to Prospect and recorded by Prospect as repayment of loan receivable:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	2,339
Year Ended June 30, 2015	1,175

The following dividends were declared and paid from R-V to Prospect and recognized as dividend income by Prospect:

Year Ended June 30, 2013	$24,462
Year Ended June 30, 2014	1,100
Year Ended June 30, 2015	298

All dividends were paid from earnings and profits of R-V.
The following interest payments were accrued and paid from R-V to Prospect and recognized by Prospect as interest income:

Year Ended June 30, 2013	$781
Year Ended June 30, 2014	3,188
Year Ended June 30, 2015	3,018

The following managerial assistance payments were paid from R-V to Prospect and subsequently remitted to Prospect Administration (no income was recognized by Prospect):

Year Ended June 30, 2013	$180
Year Ended June 30, 2014	180
Year Ended June 30, 2015	180

The following managerial assistance payments received by Prospect had not yet been remitted to Prospect Administration and were included by Prospect within due to Prospect Administration:

June 30, 2014	$45
June 30, 2015	45

The following payments were paid from R-V to Prospect Administration as reimbursement for legal, tax and portfolio level accounting services provided directly to R-V (no direct income was recognized by Prospect, but Prospect was given credit for these payments as a reduction of the administrative services costs payable by Prospect to Prospect Administration):

Year Ended June 30, 2013	$37
Year Ended June 30, 2014	—
Year Ended June 30, 2015	13

The following amounts were due to R-V from Prospect for reimbursement of expenses paid by R-V on behalf of Prospect and were included by Prospect within other liabilities:

June 30, 2014	$2
June 30, 2015	2

United Property REIT Corp.
Prospect owns 100% of the equity of UPH Property Holdings, LLC (“UPH”), a Consolidated Holding Company. UPH owns 100% of the common equity of United Property REIT Corp. (f/k/a United Property Holdings Corp.) (“UPRC”). UPRC is a Maryland corporation and a qualified REIT for federal income tax purposes. In order to qualify as a REIT, UPRC issued 125 shares of Series A Cumulative Non-Voting Preferred Stock to 125 accredited investors. The preferred stockholders are entitled to receive cumulative dividends semi-annually at an annual rate of 12.5% and do not have the ability to participate in the management or operation of UPRC.
UPRC was formed to hold for investment, operate, finance, lease, manage, and sell a portfolio of real estate assets and engage in any and all other activities as may be necessary, incidental or convenient to carry out the foregoing. UPRC acquires real estate assets, including, but not limited to, industrial, commercial, and multi-family properties. UPRC may acquire real estate assets directly or through joint ventures by making a majority equity investment in a property-owning entity (the “JV”).
On December 31, 2013, APRC distributed its majority interests in five JVs holding real estate assets to APH. APH then distributed these JV interests to Prospect in a transaction characterized as a return of capital. Prospect, on the same day, contributed certain of these JV interests to NPH and the remainder to UPH (each wholly-owned subsidiaries of Prospect). Each of NPH and UPH immediately thereafter contributed these JV interests to NPRC and UPRC, respectively. The total investments in the JVs transferred to UPH and from UPH to UPRC consisted of $18,855 and $3,707 of debt and equity financing, respectively. There was no material gain or loss realized on these transactions.
Effective April 1, 2014, Prospect made a new $19,027 senior term loan to UPRC. UPRC then distributed this amount to UPH as a return of capital which was used to pay down the Senior Term Loan from UPH by the same amount.

On June 4, 2014, Prospect made a $1,405 investment in UPH to purchase additional membership interests of UPH, which was revised to $1,420 on July 1, 2014. The proceeds were utilized by UPH to purchase additional UPRC common equity for $1,420. The proceeds were utilized by UPRC to acquire the real property located at 1201 West College, Marshall, MO ("Taco Bell, MO") for $1,405 and pay $15 of third party expenses.
On July 1, 2014, Prospect began consolidating UPH. As a result, any transactions between UPH and Prospect are eliminated in consolidation and as such, transactions after July 1, 2014 are not presented below.
On August 19, 2014 and August 27, 2014, Prospect made a combined $11,046 investment in UPRC, of which $9,389 was a Senior Term Loan directly to UPRC and $1,657 was used to purchase additional common equity of UPRC through UPH. On October 1, 2015, UPRC distributed $376 to Prospect as a return of capital. The net proceeds were utilized by UPRC to purchase an 85.0% ownership interest in Michigan Storage, LLC for $10,579, with $42 retained by UPRC for working capital and $49 restricted for future property acquisitions. The JV was purchased for $38,275 which included debt financing and minority interest of $28,705 and $1,867, respectively. The remaining proceeds were used to pay $210 of structuring fees to Prospect (which was recognized by Prospect as structuring fee income), $2,589 of third party expenses, and $77 for legal services provided by attorneys at Prospect Administration. The investment was subsequently contributed to NPRC.
On September 29, 2014, Prospect made a $22,618 investment in UPRC, of which $19,225 was a Senior Term Loan and $3,393 was used to purchase additional common equity of UPRC through UPH. The proceeds were utilized by UPRC to purchase a 92.5% ownership interest in Canterbury Green Apartments Holdings, LLC for $22,036, with $582 retained by UPRC for working capital. The JV was purchased for $85,500 which included debt financing and minority interest of $65,825 and $1,787, respectively. The remaining proceeds were used to pay $432 of structuring fees to Prospect (which was recognized by Prospect as structuring fee income), $2,135 of third party expenses, $82 for legal services provided by attorneys at Prospect Administration, and $1,249 of prepaid assets, with $250 retained by the JV for working capital.
On September 30, 2014 and October 29, 2014, Prospect made a combined $22,688 investment in UPRC, of which $19,290 was a Senior Term Loan and $3,398 was used to purchase additional common equity of UPRC through UPH. The proceeds were utilized by UPRC to purchase a 66.2% ownership interest in Columbus OH Apartment Holdco, LLC for $21,992 and to pay $241 of structuring fees to Prospect (which was recognized by Prospect as structuring fee income), with $455 retained by UPRC for working capital. The JV was purchased for $114,377 which included debt financing and minority interest of $97,902 and $11,250, respectively. The remaining proceeds were used to pay $440 of structuring fees to Prospect (which was recognized by Prospect as structuring fee income), $7,711 of third party expenses, $180 for legal services provided by attorneys at Prospect Administration, $6,778 in pre-funded capital expenditures, and $1,658 of prepaid assets.
On October 23, 2014, UPRC transferred its investment in Michigan Storage, LLC to NPRC. As a result, Prospect's investments in UPRC related to these properties also transferred to NPRC. The investments transferred consisted of $1,281 of equity and $9,444 of debt. There was no gain or loss realized on the transaction.
On November 12, 2014, Prospect made a $669 investment in UPRC, of which $569 was a Senior Term Loan and $100 was used to purchase additional common equity of UPRC through UPH. The proceeds were utilized by UPRC to purchase additional ownership interest in South Atlanta Portfolio Holding Company, LLC for $667, with $2 retained by UPRC for working capital. The minority interest holder also invested an additional $53 in the JV. The proceeds were used by the JV to fund $707 of capital expenditures and pay $13 of structuring fees to Prospect (which was recognized by Prospect as structuring fee income).
On April 27, 2015, Prospect made a $733 investment in UPRC, of which $623 was a Senior Term Loan and $110 was used to purchase additional common equity of UPRC through UPH. The proceeds were utilized by UPRC to purchase additional ownership interest in South Atlanta Portfolio Holding Company, LLC for $731 and pay $2 of legal services provided by attorneys at Prospect Administration. The minority interest holder also invested an additional $59 in the JV. The proceeds were used by the JV to fund $775 of capital expenditures and pay $15 of structuring fees to Prospect (which was recognized by Prospect as structuring fee income).
On May 19, 2015, Prospect made a $4,730 investment in UPRC, of which $3,926 was a Senior Term Loan and $804 was used to purchase additional common equity of UPRC through UPH. The proceeds were utilized by UPRC to purchase additional ownership interest in Columbus OH Apartment Holdco, LLC for $4,658, with $72 retained by

UPRC for working capital. The proceeds were used by the JV to fund $4,565 of capital expenditures and pay $93 of structuring fees to Prospect (which was recognized by Prospect as structuring fee income).

The following dividends were declared and paid from UPRC to UPH and recognized as dividend income by UPH:
Year Ended June 30, 2013 $ —
Year Ended June 30, 2014 510
Year Ended June 30, 2015 —
All dividends were paid from earnings and profits of UPRC.
The following interest payments were accrued and paid by UPH to Prospect and recognized by Prospect as interest income:
Year Ended June 30, 2013 $ —
Year Ended June 30, 2014 548
Year Ended June 30, 2015 N/A
Included above, the following payment-in-kind interest from UPH was capitalized and recognized by Prospect as interest income:
Year Ended June 30, 2013 $ —
Year Ended June 30, 2014 173
Year Ended June 30, 2015 N/A
The following interest payments were accrued and paid by UPRC to Prospect and recognized by Prospect as interest income:
Year Ended June 30, 2013 $ —
Year Ended June 30, 2014 553
Year Ended June 30, 2015 5,893
Included above, the following payment-in-kind interest from UPRC was capitalized and recognized by Prospect as interest income:
Year Ended June 30, 2013 $ —
Year Ended June 30, 2014 —
Year Ended June 30, 2015 162
The following interest income recognized had not yet been paid by UPRC to Prospect and was included by Prospect within interest receivable:
June 30, 2014 $6
June 30, 2015 20
The following royalty payments were paid from UPH to Prospect and recognized by Prospect as other income:
Year Ended June 30, 2013 $ —
Year Ended June 30, 2014 156
Year Ended June 30, 2015 N/A
The following royalty payments were paid from UPRC to Prospect and recognized by Prospect as other income:
Year Ended June 30, 2013 $ —
Year Ended June 30, 2014 —
Year Ended June 30, 2015 901
The following managerial assistance payments were paid from UPRC to Prospect and subsequently remitted to Prospect Administration (no income was recognized by Prospect):
Year Ended June 30, 2013 $ —
Year Ended June 30, 2014 100
Year Ended June 30, 2015 200

The following managerial assistance payments received by Prospect had not yet been remitted to Prospect Administration and were included by Prospect within due to Prospect Administration:
June 30, 2014 $50
June 30, 2015 50
The following payments were paid from UPRC to Prospect Administration as reimbursement for legal, tax and portfolio level accounting services provided directly to UPRC (no direct income was recognized by Prospect, but Prospect was given credit for these payments as a reduction of the administrative services costs payable by Prospect to Prospect Administration):
Year Ended June 30, 2013 $ —
Year Ended June 30, 2014 85
Year Ended June 30, 2015 262
The following amounts were due from UPRC to Prospect for reimbursement of expenses paid by Prospect on behalf of UPRC and were included by Prospect within other receivables:
June 30, 2014 $32
June 30, 2015 15
Valley Electric Company, Inc.
Prospect owns 100% of the common stock of Valley Electric Holdings I, Inc. (“Valley Holdings I”), a Consolidated Holding Company. Valley Holdings I owns 100% of Valley Electric Holdings II, Inc. (“Valley Holdings II”), a Consolidated Holding Company. Valley Holdings II owns 94.99% of Valley Electric Company, Inc. (“Valley Electric”), with Valley Electric management owning the remaining 5.01% of the equity. Valley Electric owns 100% of the equity of VE Company, Inc., which owns 100% of the equity of Valley Electric Co. of Mt. Vernon, Inc. (“Valley”), a leading provider of specialty electrical services in the state of Washington and among the top 50 electrical contractors in the United States.
On December 31, 2012, Prospect initially invested $52,098 (including 4,141,547 common shares of Prospect at a fair value of $44,650) in exchange for $32,572 was in the form of a senior secured note to Valley Holdings I, a $10,000 senior secured note to Valley (discussed below) and $9,526 to purchase the common stock of Valley Holdings I. The proceeds were partially utilized by Valley Holdings I to purchase 100% of Valley Holdings II common stock for $40,528. The remaining proceeds at Valley Holdings I were used to pay $977 of structuring fees from Valley Holdings I to Prospect (which were recognized by Prospect as structuring fee income), $345 for legal services provided by attorneys at Prospect Administration and $248 was retained by Valley Holdings I for working capital. The $40,528 of proceeds received by Valley Holdings II were subsequently used to purchase 96.3% of Valley’s common stock. Valley management provided a $1,500 co-investment in Valley.
On December 31, 2012, Prospect invested $10,000 (as mentioned above) into Valley in the form of senior secured debt. Total proceeds of $52,028 received by Valley (including $42,028 equity investment mentioned above) were used to purchase the equity of Valley from third-party sellers for $45,650, pay $4,628 of third-party transaction expenses (including bonuses to Valley’s management of $2,320), pay $250 from Valley to Prospect (which were recognized by Prospect as structuring fee income) and $1,500 was retained by Valley for working capital.
On June 24, 2014, Valley Holdings II and management of Valley formed Valley Electric and contributed their shares of Valley stock to Valley Electric. Valley management made an additional equity investment in Valley Electric, reducing our ownership to 94.99%. Prospect made a new $20,471 senior secured loan to Valley Electric. Valley Electric then distributed this amount to Valley Holdings I, via Valley Holdings II, as a return of capital which was used to pay down the senior secured note of Valley Holdings I by the same amount. The remaining principal amount of the senior secured note, $16,754, was then contributed to the capital of Valley Holdings I.
On July 1, 2014, Prospect began consolidating Valley Holdings I and Valley Holdings II. As a result, any transactions between Valley Holdings I, Valley Holdings II and Prospect are eliminated in consolidation and as such, transactions after July 1, 2014 are not presented below.

In addition to the repayments noted above, the following amounts were paid from Valley to Prospect and recorded by Prospect as repayment of loan receivable:

Year Ended June 30, 2013	$100
Year Ended June 30, 2014	200
Year Ended June 30, 2015	—

The following dividends were declared and paid from Valley to Valley Holdings II, which were subsequently distributed to and recognized as dividend income by Valley Holdings I:

Year Ended June 30, 2013	$1,867
Year Ended June 30, 2014	2,953
Year Ended June 30, 2015	—

All dividends were paid from earnings and profits of Valley and Valley Holdings II.

The following interest payments were accrued and paid from Valley Holdings I to Prospect and recognized by Prospect as interest income:

Year Ended June 30, 2013	$2,982
Year Ended June 30, 2014	6,323
Year Ended June 30, 2015	N/A

Included above, the following payment-in-kind interest from Valley Holdings I was capitalized and recognized by Prospect as interest income:

Year Ended June 30, 2013	$1,491
Year Ended June 30, 2014	3,162
Year Ended June 30, 2015	N/A

The following interest payments were accrued and paid from Valley Electric to Prospect and recognized by Prospect as interest income:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	74
Year Ended June 30, 2015	3,905

Included above, the following payment-in-kind interest from Valley Electric was capitalized and recognized by Prospect as interest income:

Year Ended June 30, 2013	$ —
Year Ended June 30, 2014	29
Year Ended June 30, 2015	1,794

The following interest income recognized had not yet been paid by Valley Electric to Prospect and was included by Prospect within interest receivable:

June 30, 2014	$45
June 30, 2015	11

The following interest payments were accrued and paid from Valley to Prospect and recognized by Prospect as interest income:

Year Ended June 30, 2013	$530
Year Ended June 30, 2014	1,074
Year Ended June 30, 2015	1,086

Included above, the following payment-in-kind interest from Valley was capitalized and recognized by Prospect as interest income:

Year Ended June 30, 2013	$126
Year Ended June 30, 2014	255
Year Ended June 30, 2015	259

The following interest income recognized had not yet been paid by Valley to Prospect and was included by Prospect within interest receivable:

June 30, 2014	$3
June 30, 2015	3

The following royalty payments were paid from Valley Holdings I to Prospect and recognized by Prospect as other income:

Year Ended June 30, 2013	$98
Year Ended June 30, 2014	148
Year Ended June 30, 2015	N/A

The following managerial assistance payments were paid from Valley to Prospect and subsequently remitted to Prospect Administration (no income was recognized by Prospect):

Year Ended June 30, 2013	$150
Year Ended June 30, 2014	300
Year Ended June 30, 2015	300

The following managerial assistance payments received by Prospect had not yet been remitted to Prospect Administration and were included by Prospect within due to Prospect Administration:

June 30, 2014	$75
June 30, 2015	75

The following payments were paid from Valley Electric to Prospect Administration as reimbursement for legal, tax and portfolio level accounting services provided directly to Valley Electric (no direct income was recognized by Prospect, but Prospect was given credit for these payments as a reduction of the administrative services costs payable by Prospect to Prospect Administration):

Year Ended June 30, 2013	$345
Year Ended June 30, 2014	91
Year Ended June 30, 2015	18

The following amounts were due to Valley Electric from Prospect for reimbursement of expenses paid by Valley Electric on behalf of Prospect and were included by Prospect within other liabilities:

June 30, 2014	$6
June 30, 2015	—

Vets Securing America, Inc.
As of June 30, 2014, Prospect owned 100% of the equity of Vets Securing America, Inc. (“VSA”) and 100% of the equity of The Healing Staff, Inc. (“THS”), a former wholly-owned subsidiary of ESA Environmental Specialists, Inc. (“ESA”). During the year ended June 30, 2015, THS ceased operations and the VSA management team supervised both the continued operations of VSA and the wind-down of activities at THS. VSA provides out-sourced security guards staffing.
As of July 1, 2011, the cost basis of Prospect’s investment in THS and VSA, including debt and equity, was $18,219. During the year ended June 30, 2012, Prospect made follow-on secured debt investments of $1,033 to support the ongoing operations of THS and VSA. In October 2011, Prospect sold a building previously acquired from ESA for $894. In January 2012, Prospect received $2,250 of litigation settlement proceeds related to ESA. The proceeds from both of these transactions were used to reduce the outstanding loan balances due from THS and VSA by $3,144. In June 2012, THS and VSA repaid $118 and $42, respectively, of loans previously outstanding.
In May 2012, in connection with the implementation of accounts receivable based funding programs for THS and VSA with a third party provider, Prospect agreed to subordinate its first priority security interest in all of the accounts receivable and other assets of THS and VSA to the third party provider of that accounts receivable based funding.
During the year ended June 30, 2013, Prospect determined that the impairment of THS and VSA was other-than-temporary and recorded a realized loss of $12,117, reducing the amortized cost to $3,831. During the year ended June 30, 2014, Prospect received $5,825 of legal cost reimbursement related to the ESA litigation settlement which had been expensed in prior years. The proceeds were recognized by Prospect as other income during the year ended June 30, 2014. During the year ended June 30, 2015, Prospect received $685 related to the ESA litigation settlement which was recognized as realized gain.
On May 20, 2015, Prospect made a new $100 secured promissory note to provide liquidity to VSA.
As of June 30, 2014, THS and VSA were joint borrowers on the secured promissory notes. On June 5, 2015, Prospect sold its equity investment in VSA and realized a net loss of $975 on the sale. In connection with the sale, VSA was released as a borrower on the secured promissory notes, leaving THS as the sole borrower. During the year ended June 30, 2015, THS ceased operations and Prospect recorded a realized loss of $2,956, reducing the amortized cost to zero.
The following amounts were due from THS and VSA to Prospect for reimbursement of expenses paid by Prospect on behalf of THS and VSA and were included by Prospect within other receivables:
June 30, 2014 $6
June 30, 2015 —
Wolf Energy, LLC
Prospect owns 100% of the equity of Wolf Energy Holdings Inc. (“Wolf Energy Holdings”), a Consolidated Holding Company. Wolf Energy Holdings owns 100% of each of Appalachian Energy LLC (f/k/a Appalachian Energy Holdings, LLC) (“AEH”); Coalbed, LLC (“Coalbed”); and Wolf Energy, LLC (“Wolf Energy”). AEH owns 100% of C&S Operating, LLC.
Wolf Energy Holdings is a holding company formed to hold 100% of the outstanding membership interests of each of AEH and Coalbed. The membership interests and associated operating company debt of AEH and Coalbed, which were previously owned by Manx Energy, Inc. (“Manx”), were assigned to Wolf Energy Holdings effective June 30, 2012. The purpose of assignment was to remove those activities from Manx deemed non-core by the Manx convertible debt investors who were not interested in funding those operations. On June 30, 2012, AEH and Coalbed loans with a cost basis of $7,991 were assigned by Prospect to Wolf Energy Holdings from Manx.
In addition, effective June 29, 2012, C&J Cladding Holding Company, Inc. (“C&J Holdings”) merged with and into Wolf Energy Holdings, with Wolf Energy Holdings as the surviving entity. At the time of the merger, C&J Holdings held the remaining undistributed proceeds in cash from the sale of its membership interests in C&J Cladding, LLC (“C&J”) (discussed below). The merger was effectuated in connection with the broader simplification of Prospect’s energy investment holdings.
On June 1, 2012, Prospect sold the membership interests in C&J for $5,500. Proceeds from the sale were used to pay a $3,000 distribution to Prospect ($580 reduction in cost basis and $2,420 realized gain recognized by Prospect), an advisory fee of $1,500 from C&J to Prospect (which was recognized by Prospect as other income) and $978 was retained by C&J as working capital to pay $22 of legal services provided by attorneys at Prospect Administration and

third-party expenses.

On February 27, 2013, Prospect made a $50 senior secured debt investment senior secured to East Cumberland, L.L.C., a former wholly-owned subsidiary of AEH with AEH as guarantor. Proceeds were used to pay off vendors.
On April 15, 2013, Prospect foreclosed on the assets of H&M Oil & Gas, LLC ("H&M"). At the time of foreclosure, H&M was in default on loans receivables due to Prospect with a cost basis of $64,449. The assets previously held by H&M were assigned by Prospect to Wolf Energy in exchange for a $66,000 term loan secured by the assets. The cost basis in this loan of $44,632 was determined in accordance with ASC 310-40, Troubled Debt Restructurings by Creditors, and was equal to the fair value of assets at the time of transfer resulting in a capital loss of $19,647 in connection with the foreclosure on the assets. On May 17, 2013, Wolf Energy sold the assets located in Martin County, which were previously held by H&M, for $66,000. Proceeds from the sale were primarily used to repay the loan, accrued interest and net profits interest receivable due to us resulting in a realized capital gain of $11,826 offsetting the previously recognized loss. Prospect received $3,960 of structuring and advisory fees from Wolf Energy during the year ended June 30, 2013 related to the sale and $991 under the net profits interest agreement which was recognized as other income during the fiscal year ended June 30, 2013.
On July 1, 2014, Prospect began consolidating Wolf Energy Holdings. As a result, any transactions between Wolf Energy Holdings and Prospect are eliminated in consolidation and as such, transactions after July 1, 2014 are not presented below.
During the three months ended September 30, 2014, Prospect determined that the impairment of AEH was other-than temporary and recorded a realized loss of $2,050, reducing the amortized cost to zero. On November 21, 2014, Coalbed merged with and into Wolf Energy, with Wolf Energy as the surviving entity. During the three months ended December 31, 2014, Prospect determined that the impairment of the Coalbed debt assumed by Wolf Energy was other-than-temporary and recorded a realized loss of $5,991, reducing the amortized cost to zero.
During the year ended June 30, 2015, Wolf Energy Holdings received a tax refund of $173 related to its investment in C&J and Prospect realized a gain of the same amount.
The following payments were paid from Wolf Energy Holdings to Prospect Administration as reimbursement for legal, tax and portfolio level accounting services provided directly to Wolf Energy Holdings (no direct income was recognized by Prospect, but Prospect was given credit for these payments as a reduction of the administrative services costs payable by Prospect to Prospect Administration):

Year Ended June 30, 2013	$ 22
Year Ended June 30, 2014	101
Year Ended June 30, 2015	N/A

Note 15. Litigation
From time to time, we may become involved in various investigations, claims and legal proceedings that arise in the ordinary course of our business. These matters may relate to intellectual property, employment, tax, regulation, contract or other matters. The resolution of these matters as they arise will be subject to various uncertainties and, even if such claims are without merit, could result in the expenditure of significant financial and managerial resources. We are not aware of any material litigation as of June 30, 2015.

Note 16. Financial Highlights

The following is a schedule of financial highlights for each of the five years in the period ended June 30, 2015:

	Year Ended June 30,				
	2015	2014	2013	2012	2011
Per Share Data					
Net asset value at beginning of year	$10.56	$10.72	$10.83	$10.36	$10.30
Net investment income(1)	1.03	1.19	1.57	1.63	1.10
Net realized losses (gains) on investments(1)	(0.51)	(0.01)	(0.13)	0.32	0.19
Net change in unrealized appreciation (depreciation) on investments(1)	0.47	(0.12)	(0.37)	(0.28)	0.09
Net realized losses on extinguishment of debt(1)	(0.01)	—	—	—	—
Dividends to shareholders	(1.19)	(1.32)	(1.28)	(1.22)	(1.21)
Common stock transactions(2)	(0.04)	0.10	0.10	0.02	(0.11)
Net asset value at end of year	$10.31	$10.56	$10.72	$10.83	$10.36
Per share market value at end of year	$7.37	$10.63	$10.80	$11.39	$10.11
Total return based on market value(3)	(20.84%)	10.88%	6.24%	27.21%	17.22%
Total return based on net asset value(3)	11.47%	10.97%	10.91%	18.03%	12.54%
Shares of common stock outstanding at end of year	359,090,759	342,626,637	247,836,965	139,633,870	107,606,690
Weighted average shares of common stock outstanding	353,648,522	300,283,941	207,069,971	114,394,554	85,978,757
Ratios/Supplemental Data					
Net assets at end of year	$3,703,049	$3,618,182	$2,656,494	$1,511,974	$1,114,357
Portfolio turnover rate	25.32%	15.21%	29.24%	29.06%	27.63%
Annualized ratio of operating expenses to average net assets	11.70%	11.11%	11.50%	10.73%	8.47%
Annualized ratio of net investment income to average net assets	9.91%	11.18%	14.86%	14.92%	10.60%

(1) Per share data amount is based on the weighted average number of common shares outstanding for the period presented (except for dividends to shareholders which is based on actual rate per share).

(2) Common stock transactions include the effect of our issuance of common stock in public offerings (net of underwriting and offering costs), shares issued in connection with our dividend reinvestment plan and shares issued to acquire investments.

(3) Total return based on market value is based on the change in market price per share between the opening and ending market prices per share in each period and assumes that dividends are reinvested in accordance with our dividend reinvestment plan. Total return based on net asset value is based upon the change in net asset value per share between the opening and ending net asset values per share in each period and assumes that dividends are reinvested in accordance with our dividend reinvestment plan.

Note 17. Selected Quarterly Financial Data (Unaudited)

The following table sets forth selected financial data for each quarter within the three years ended June 30, 2015.

	Investment Income		Net Investment Income		Net Realized and Unrealized Gains (Losses)		Net Increase in Net Assets from Operations	
Quarter Ended	Total	Per Share(1)	Total	Per Share(1)	Total	Per Share(1)	Total	Per Share(1)
September 30, 2012	$ 123,636	$ 0.76	$ 74,027	$ 0.46	$ (26,778)	$ (0.17)	$ 47,249	$ 0.29
December 31, 2012	166,035	0.85	99,216	0.51	(52,727)	(0.27)	46,489	0.24
March 31, 2013	120,195	0.53	59,585	0.26	(15,156)	(0.07)	44,429	0.20
June 30, 2013	166,470	0.68	92,096	0.38	(9,407)	(0.04)	82,689	0.34
September 30, 2013	161,034	0.62	82,337	0.32	(2,437)	(0.01)	79,900	0.31
December 31, 2013	178,090	0.62	92,215	0.32	(6,853)	(0.02)	85,362	0.30
March 31, 2014	190,327	0.60	98,523	0.31	(16,422)	(0.05)	82,101	0.26
June 30, 2014	182,840	0.54	84,148	0.25	(12,491)	(0.04)	71,657	0.21
September 30, 2014	202,021	0.59	94,463	0.28	(10,355)	(0.04)	84,108	0.24
December 31, 2014	198,883	0.56	91,325	0.26	(5,355)	(0.02)	85,970	0.24
March 31, 2015	191,350	0.53	87,441	0.24	(5,949)	(0.01)	81,492	0.23
June 30, 2015	198,830	0.55	89,518	0.25	5,251	0.01	94,769	0.26

(1) Per share amounts are calculated using the weighted average number of common shares outstanding for the period presented. As such, the sum of the quarterly per share amounts above will not necessarily equal the per share amounts for the fiscal year.

Note 18. Subsequent Events

On July 1, 2015, we provided $31,000 of first lien senior secured financing, of which $30,200 was funded at closing, to Intelius, Inc. (“Intelius”), an online information commerce company.

On July 8, 2015, we sold 27.45% of the outstanding principal balance of the senior secured Term Loan A investment in InterDent, Inc. for $34,415. There was no gain or loss realized on the sale.

On July 23, 2015, we made an investment of $37,969 to purchase 80.73% of the subordinated notes in Halcyon Loan Advisors Funding 2015-3 Ltd. in a co-investment transaction with Priority Income Fund, Inc., a closed-end fund managed by an affiliate of Prospect Capital Management.

On July 23, 2015, we issued 193,892 shares of our common stock in connection with the dividend reinvestment plan.

On July 24, 2015, TB Corp. repaid the $23,628 loan receivable to us.

On August 6, 2015, we provided $92,500 of first lien senior secured debt to support the refinancing of Crosman Corporation. Concurrent with the refinancing, we received repayment of the $40,000 second lien term loan previously outstanding.

On August 7, 2015, Ryan, LLC repaid the $72,701 loan receivable to us.

On August 11, 2015, we made a $13,500 follow-on first lien senior secured debt investment in Intelius, of which $13,000 was funded at closing, to support an acquisition.

On August 12, 2015, we made an investment of $22,898 to purchase 50.04% of the subordinated notes in Octagon Investment Partners XVIII, Ltd.

On August 12, 2015, we sold 780 of our small business whole loans purchased from OnDeck to Jefferies Asset Funding LLC for proceeds of $26,562, net of related transaction expenses, and a trust certificate representing a 41.54% interest in the MarketPlace Loan Trust, Series 2015-OD2.

On August 14, 2015, we announced the then current conversion rate on the 2018 Notes as 84.1497 shares of common stock per $1 principal amount of the 2018 Notes converted, which is equivalent to a conversion price of approximately $11.88.
On August 20, 2015, we issued 152,896 shares of our common stock in connection with the dividend reinvestment plan.

On August 21, 2015, we committed to funding a $16,000 second lien secured investment in a provider of customer care outsourcing services.

During the period from July 1, 2015 through August 26, 2015, we made seven follow-on investments in NPRC totaling $52,852 to support the online consumer lending initiative. We invested $12,508 of equity through NPH and $40,344 of debt directly to ACL Loan Holdings, Inc., a wholly-owned subsidiary of NPRC.

During the period from July 1, 2015 through August 26, 2015, our wholly-owned subsidiary PSBL purchased $14,101 of small business whole loans from OnDeck.

During the period from July 1, 2015 through August 26, 2015, we issued $32,362 aggregate principal amount of Prospect Capital InterNotes® for net proceeds of $31,870. In addition, we sold $1,425 aggregate principal amount of Prospect Capital InterNotes® for net proceeds of $1,405 with expected closing on August 27, 2015.

During the period from July 28, 2015 through August 14, 2015 (with settlement dates of July 31, 2015 to August 19, 2015), we repurchased 4,158,750 shares of our common stock at an average price of $7.22 per share, including commissions.

On August 24, 2015, we announced the declaration of monthly dividends in the following amounts and with the following dates:

- $0.08333 per share for September 2015 to holders of record on September 30, 2015 with a payment date of October 22, 2015; and
- $0.08333 per share for October 2015 to holders of record on October 30, 2015 with a payment date of November 19, 2015.

First Tower Finance Company LLC
and Subsidiaries
(formerly First Tower Holdings LLC)
Consolidated Financial Statements
December 31, 2014 and 2013

Independent Auditor’s Report

To the Board of Members
First Tower Finance Company LLC and Subsidiaries
Flowood, Mississippi

Report on the Financial Statements
We have audited the accompanying consolidated financial statements of First Tower Finance Company LLC and Subsidiaries (the “Company”) which comprise the consolidated balance sheets as of December 31, 2014 and 2013, and the related consolidated statements of income and comprehensive income, changes in members’ equity (deficit), and cash flows for the years then ended and the related notes to the consolidated financial statements.
Management’s Responsibility for the Financial Statements
Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.
Auditor’s Responsibility
Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.
An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor’s judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity’s internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.
We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2014 and 2013, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Raleigh, North Carolina
March 31, 2015

First Tower Finance Company LLC and Subsidiaries
(formerly First Tower Holdings LLC)

Consolidated Balance Sheets
December 31, 2014 and 2013

	2014	2013
Assets		
Cash and cash equivalents	$10,906,825	$5,821,481
Investment in trading securities	1,594,391	1,473,768
Investment securities available for sale	51,942,251	49,536,651
Finance receivables, net	431,395,397	421,309,663
Prepaid reinsurance premiums	24,645	392,662
Reinsurance receivable and recoverable	1,239,614	1,687,537
Other receivables	601,794	686,865
Real estate acquired by foreclosure	834,832	797,935
Property and equipment, net	11,839,506	8,563,664
Deferred policy acquisition costs	976,967	874,979
Intangible assets, net	20,769,578	23,384,176
Goodwill	108,941,160	122,558,807
Debt issue costs, net	1,037,384	3,068,778
Other assets	503,727	543,920
Total assets	$642,608,071	$640,700,886
Liabilities and Members' Equity (Deficit)		
Liabilities:		
Notes payable	$291,497,668	$276,900,091
Subordinated notes payable to members	313,844,000	—
Unearned premiums	40,585,670	38,531,397
Policy claim reserves	2,386,867	2,524,084
Accounts payable and accrued expenses	6,708,800	5,644,448
Other liabilities	1,518,504	1,383,523
Deferred tax liabilities, net	3,831,412	3,003,771
Total liabilities	660,372,921	327,987,314
Commitments and contingencies		
Members' Equity (Deficit):		
Class A members	(18,221,959)	312,771,733
Class B members	(50,402)	138,051
Class C members	—	—
Class D members	177,298	107,542
Accumulated other comprehensive income (loss), net of income tax effect of $196,000 and ($181,000) as of December 31, 2014 and 2013, respectively	330,213	(303,754)
Total members' equity (deficit)	(17,764,850)	312,713,572
Total liabilities and members' equity (deficit)	$642,608,071	$640,700,886

See notes to consolidated financial statements.

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First Tower Finance Company LLC and Subsidiaries
(formerly First Tower Holdings LLC)

Consolidated Statements of Income and Comprehensive Income
Years Ended December 31, 2014 and 2013

	2014	2013
Revenues:		
Interest and fee income from finance receivables	$162,821,460	$162,687,677
Insurance premiums	31,137,142	23,613,523
Net investment income	836,748	770,771
Net realized investment gains (losses)	(53,942)	110,837
Other income	11,615,562	9,982,617
Total revenues	206,356,970	197,165,425
Expenses:		
Interest expense	44,205,889	11,758,168
Policyholders’ benefits	5,184,863	5,105,706
Salaries and fringe benefits	36,514,752	33,260,014
Provision for credit losses	56,186,665	59,937,057
Other operating expenses	46,900,257	43,706,625
Total expenses	188,992,426	153,767,570
Income before income taxes	17,364,544	43,397,855
Provision for income taxes	432,948	1,527,828
Net income	16,931,596	41,870,027
Other comprehensive income (loss), net of income tax effects of approximately $377,000 as of December 31, 2014 and ($383,000) as of December 31, 2013		
Unrealized holding gains (losses) on securities	601,967	(650,223)
Reclassification adjustments for amounts included in net income	32,000	19,537
Other comprehensive income (loss)	633,967	(630,686)
Comprehensive income	$17,565,563	$41,239,341

See notes to consolidated financial statements.

First Tower Finance Company LLC and Subsidiaries
(formerly First Tower Holdings LLC)

Consolidated Statements of Changes in Members' Equity (Deficit)
Years Ended December 31, 2014 and 2013

	Class A Members Equity (Deficit)	Class B Members Equity (Deficit)	Class C Members Equity	Class D Members Equity	Accumulated Over Comprehensive Income (Loss)	Total
Balance, January 1, 2013	$333,687,368	$149,960	$ —	$37,786	$ 326,932	$334,202,046
Member compensation vested	—	—	—	69,756	—	69,756
Net income	41,846,202	23,825	—	—	—	41,870,027
Distributions paid	(62,761,837)	(35,734)	—	—	—	(62,797,571)
Change in net unrealized gain (loss) on investment securities available for sale	—	—	—	—	(630,686)	(630,686)
Balance, January 1, 2014	312,771,733	138,051	—	107,542	(303,754)	312,713,572
Member compensation vested	—	—	—	69,756	—	69,756
Net income	16,921,961	9,635	—	—	—	16,931,596
Distributions paid	(34,250,240)	(19,501)	—	—	—	(34,269,741)
Subordinated debt financed distributions	(313,665,413)	(178,587)	—	—	—	(313,844,000)
Change in net unrealized gain (loss) on investment securities available for sale	—	—	—	—	633,967	633,967
Balance, December 31, 2014	$(18,221,959)	$(50,402)	$ —	$177,298	$ 330,213	$(17,764,850)

See notes to consolidated financial statements.

First Tower Finance Company LLC and Subsidiaries
(formerly First Tower Holdings LLC)

Consolidated Statements of Cash Flows
Years Ended December 31, 2014 and 2013

	2014	2013
Cash Flows From Operating Activities		
Net income	$16,931,596	$41,870,027
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	20,764,275	20,208,165
Amortization of discount on securities, net	1,191,607	1,206,979
Loss on sales of investments - net	51,822	31,639
(Gain) loss on trading securities	2,120	(142,476)
(Gain) loss on sales of assets	(49,744)	52,104
Loss from sales and impairments of real estate	261,360	237,494
Deferred income tax provision	450,495	1,527,828
Provision for credit losses	56,186,665	59,937,057
Compensation expense	69,756	69,756
Net loan costs deferred	(968,792)	(1,853,270)
PIK Rate interest added to principal	1,113,196	—
Purchase of trading securities	(123,603)	(1,500,907)
Proceeds from sales of trading securities	860	1,298,643
Changes in operating assets and liabilities:		
Reinsurance recoverables	815,940	1,680,368
Receivables	85,071	(111,352)
Other assets	40,193	(149,946)
Deferred policy acquisition cost	(101,988)	(874,979)
Policy claim reserves	(137,217)	(47,454)
Accounts payable and accrued expenses	1,064,352	499,466
Unearned premiums	2,054,273	6,764,783
Other liabilities	134,981	11,937
Net cash provided by operating activities	$99,837,218	$130,715,862

(Continued)

First Tower Finance Company LLC and Subsidiaries
(formerly First Tower Holdings LLC)

Consolidated Statements of Cash Flows (Continued)
Years Ended December 31, 2014 and 2013

	2014	2013
Cash Flows From Investing Activities		
Loans originated	$(586,037,272)	$(556,300,281)
Loans repaid or sold	519,686,122	477,608,635
Proceeds from sales of investment in real estate	749,286	442,415
Proceeds from calls or maturities of investment securities	5,113,523	5,026,869
Proceeds from sales of investment securities	7,480,249	5,793,902
Purchases of investment securities	(15,231,688)	(16,434,774)
Proceeds from sales of property and equipment	129,829	79,180
Purchase of property and equipment	(5,856,563)	(3,796,359)
Net cash used in investing activities	(73,966,514)	(87,580,413)
Cash Flows From Financing Activities		
Net changes in short-term borrowings	14,597,577	19,804,437
Principal payments on subordinated notes payable	(1,113,196)	—
Debt issue cost paid	—	(300,000)
Distributions paid	(34,269,741)	(62,797,571)
Net cash used in financing activities	(20,785,360)	(43,293,134)
Increase (decrease) in cash and cash equivalents	5,085,344	(157,685)
Cash and cash equivalents		
Beginning of period	5,821,481	5,979,166
End of period	$10,906,825	$5,821,481
Supplemental Disclosures of Cash Flow Information		
Real estate acquired in satisfaction of finance receivables	$1,048,000	$790,000
Return of capital distributed as subordinated notes payable to members	$313,844,000	$—
Cash payments for interest on notes payable	$9,972,000	$13,003,000
Cash payments for interest, including paid-in-kind interest, on subordinated notes payable to members	$32,203,000	$—

See notes to consolidated financial statements.

First Tower Finance Company LLC and Subsidiaries
(formerly First Tower Holdings LLC)

Notes to Consolidated Financial Statements

Note 1. Nature of Business and Significant Accounting Policies

Nature of business: First Tower Finance Company LLC (formerly First Tower Holdings LLC) is a Mississippi limited liability company and is engaged in consumer lending and related insurance activities through its wholly-owned subsidiaries, First Tower, LLC, Tower Loan of Mississippi, LLC, Tower Loan of Illinois, LLC, First Tower Loan, LLC, Gulfco of Mississippi, LLC, Gulfco of Alabama, LLC, Gulfco of Louisiana, LLC, Tower Loan of Missouri, LLC, and Tower Auto Loan, LLC. Tower Loan of Mississippi, LLC is the sole member of American Federated Holding Company, which has two wholly-owned subsidiaries, American Federated Insurance Company (AFIC), and American Federated Life Insurance Company (AFLIC). These entities are collectively referred to as “the Company”. The Company acquires and services finance receivables (direct loans, real estate loans and sales finance contracts) through branch offices principally located in Mississippi, Louisiana, Alabama, Illinois and Missouri. In addition, the Company writes credit insurance when requested by its loan customers.

Government regulation: The Company is subject to various state and federal laws and regulations in each of the states in which it operates that are enforced by the respective state regulatory authorities. These state laws and regulations impact the economic terms of the Company’s products. In addition, these laws regulate collection procedures, the keeping of books and records and other aspects of the operation of consumer finance companies. As a result, the terms of products offered by the Company vary among the states in which it operates in order to comply with each state’s specific laws and regulations.

Each of the Company’s branch offices is separately licensed under the laws of the state in which the office is located. Licenses granted by the regulatory agencies in these states are subject to renewal every year and may be revoked for failure to comply with applicable state and federal laws and regulations.

The Company is also subject to state regulations governing insurance agents in the states in which it sells credit insurance. State insurance regulations require that insurance agents be licensed; govern the commissions that may be paid to agents in connection with the sale of credit insurance and limit the premium amount charged for such insurance.

A summary of the Company’s significant accounting policies follows:

Principles of consolidation: In accordance with the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification Topic (“ASC”) 810, Consolidation, a company’s consolidated financial statements are required to include subsidiaries in which the company has a controlling financial interest. The consolidated financial statements include the accounts of the Company and its subsidiaries, all of which are wholly-owned. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates: The Company’s consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America. In preparing its financial statements, the Company is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the dates of the balance sheets and the reported amounts of revenues and expenses for the years ended December 31, 2014 and 2013. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to change include the determination of the allowance for credit losses, policy claim reserves, impairment of goodwill, deferred tax assets and liabilities and the valuation of investments.

Investment in Trading Securities: The Company has an investment in a large capitalization equity mutual fund which is classified as a trading security. Changes in the unrealized gains and losses of this investment are recognized through earnings. Dividends on trading securities are recognized in net investment income.

First Tower Finance Company LLC and Subsidiaries
(formerly First Tower Holdings LLC)

Notes to Consolidated Financial Statements

Note 1. Nature of Business and Significant Accounting Policies (Continued)
Investment Securities Available for Sale: Investments in debt securities are classified as available for sale. Available for sale securities are carried at fair value, with changes in the fair value of such securities being reported as other comprehensive income (loss), net of related deferred income taxes (benefit). When the fair value of a security falls below carrying value, an evaluation must be made to determine if the unrealized loss is a temporary or other than temporary impairment. Impaired debt securities that are not deemed to be temporarily impaired are written down to net realizable value by a charge to earnings to the extent the impairment is related to credit losses or if the Company intends, or more-likely-than not will be required, to sell the security before recovery of the security's amortized cost basis. In estimating other than temporary impairments, the Company considers the duration of time and extent to which the amortized cost exceeds fair value, the financial condition of the issuer, and the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for anticipated recovery in fair value.
Premiums and discounts on debt securities are recognized as adjustments to net investment income by the interest method over the period to maturity and adjusted for prepayments as applicable. Realized gains and losses on sales of investment securities are determined using the specific identification method.
Fair Value Measurements: The Company carries its trading securities, and its investment securities available-for-sale at fair value on a recurring basis and measures certain other assets and liabilities at fair value on a nonrecurring basis using a hierarchy of measurements which requires it to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.
Three levels of inputs are used to measure fair value:

Level 1	Valuations based on unadjusted quoted prices for identical assets in active markets accessible at the measurement date.
Level 2	Valuations derived for similar assets in active markets, or other inputs that are observable or can be corroborated by market data.
Level 3	Valuations derived from unobservable (supported by little or no market activity) inputs that reflect an entity's best estimate of what hypothetical market participants would use to determine a transaction price at the reporting date.

When quoted market prices in active markets are unavailable, the Company determines fair value using various valuation techniques and models based on a range of observable market inputs including pricing models, quoted market price of publicly traded securities with similar duration and yield, time value, yield curve, prepayment speeds, default rates and discounted cash flow. In most cases, these estimates are determined based on independent third party valuation information, and the amounts are disclosed as Level 2. Generally, the Company obtains a single price or quote per instrument from independent third parties to assist in establishing the fair value of these investments.
If quoted market prices and independent third party valuation information are unavailable, the Company produces an estimate of fair value based on internally developed valuation techniques, which, depending on the level of observable market inputs, will render the fair value estimate as Level 2 or 3.
On occasions when pricing service data is unavailable, the Company may rely on bid/ask spreads from dealers in determining fair value.
To the extent the Company determines that a price or quote is inconsistent with actual trading activity observed in that investment or similar investments, or if the Company does not think the quote is reflective of the market value for the investment, the Company internally develops a fair value using this other market information and discloses the input as a Level 3.

First Tower Finance Company LLC and Subsidiaries
(formerly First Tower Holdings LLC)

Notes to Consolidated Financial Statements

Note 1. Nature of Business and Significant Accounting Policies (Continued)
Finance Receivables: Finance receivables are stated at the amount of unpaid principal and finance charges, including deferred loan costs, and reduced by unearned finance charges, unearned discounts and an allowance for credit losses. Non-refundable loan origination fees and certain direct origination costs are deferred and recognized as an adjustment of the finance receivable yield over the contractual life of the related loan using the interest method. Unamortized amounts are recognized in income when finance receivables are renewed or paid in full.
Real Estate Acquired by Foreclosure: The Company records real estate acquired by foreclosure at the lesser of the outstanding finance receivable amount (including accrued interest, if any) or fair value, less estimated costs to sell, at the time of foreclosure. Any resulting loss on foreclosure is charged to the allowance for credit losses and a new basis is established in the property. A valuation allowance and a corresponding charge to operations is established to reflect declines in value subsequent to acquisition, if any, below the new basis. Operating expenses of such properties, net of related income, and gains and losses on their disposition are included in other operating expenses.
Property and Equipment: Property and equipment are stated at cost. Depreciation is computed using the straight-line method. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to income when incurred; significant improvements and betterments are capitalized. The Company evaluates the recoverability of property, plant and equipment and other long-term assets when events or changes in circumstances indicate that the carrying value of such assets may not be recoverable, based upon expectations of non-discounted cash flows and operating income.
Goodwill and Other Intangible Assets: Goodwill represents the excess of the consideration transferred in a business combination over the fair value of the identifiable net assets acquired. Other intangible assets represent purchased assets that also lack physical substance but can be distinguished from goodwill because of contractual or other legal rights. Intangibles with finite lives are amortized over their estimated useful lives. Additionally, during 2013, the Company elected to early adopt the alternative permitted for private companies and began amortizing goodwill over ten years by the straight-line method. Goodwill and other intangible assets are subject to impairment testing annually or more frequently if events or circumstances indicate possible impairment. Other intangible assets consist of trade names, sales finance relationships, non-competition and license agreements and internally developed technology. Intangible assets are reviewed for events or circumstances which could impact the recoverability of the intangible asset, such as a loss of significant relationships, increased competition or adverse changes in the economy. No impairment was identified for the Company’s goodwill or its other intangible assets during 2014 and 2013.
Debt Issue Costs: Debt issue costs represents costs associated with obtaining the Company’s credit facility, and is amortized on a straight line basis over the life of the related financing agreement which approximates the interest method. Amortization expense for the years ended December 31, 2014 and 2013 approximated $2,031,000 and$1,925,000, respectively, and is included in interest expense.
Deferred Policy Acquisition Costs: Costs incurred to acquire credit insurance policies are deferred and amortized over the life of the underlying insurance contracts.
Income Recognition: Precomputed finance charges are included in the gross amount of the Company’s finance receivables. These precomputed charges are deferred and recognized as income on an accrual basis using the effective interest method over the terms of receivables. However, with certain exceptions, state regulations allow interest refunds to be made according to the Rule of 78’s method for payoffs and renewals. Since a significant percentage of the Company’s precomputed accounts are paid off or renewed prior to maturity, the result is that a majority of the precomputed accounts effectively yield on a Rule of 78’s basis. The difference between income previously recognized under the interest yield method and the Rule of 78’s method is recognized as an adjustment to interest income at the time of the renewal or payoff.

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Explanation of Responses:

First Tower Finance Company LLC and Subsidiaries
(formerly First Tower Holdings LLC)

Notes to Consolidated Financial Statements

Note 1. Nature of Business and Significant Accounting Policies (Continued)
Insurance premiums on credit life and accident and health policies written by the Company are earned over the term of the policy using the pro-rata method, for level-term life policies, and the effective yield method, for decreasing-term life policies. Premiums on accident and health policies are earned based on an average of the pro-rata method and the effective yield method. Property and casualty credit insurance premiums written by the Company are earned over the period of insurance coverage using the pro-rata method or the effective yield method, depending on whether the amount of insurance coverage generally remains level or declines.
Commissions earned from the sale of accidental death and dismemberment insurance coverage and motor club memberships to finance customers are recognized at the time of origination. The Company has no future obligations related to the sale of these products. Other income includes commissions earned of approximately $10,175,000 and $9,012,000 for the year ended December 31, 2014 and 2013, respectively.
Credit Losses: For periods subsequent to the acquisition date of the acquired finance receivables portfolio and for finance receivables originated by the Company, the allowance for credit losses is determined by several factors based upon each portfolio segment. Segments in the finance receivable portfolio include personal property, real estate and sales finance. Historical loss experience is the primary factor in the determination of the allowance for credit losses. An evaluation is performed to compare the amount of accounts charged off, net of recoveries of such accounts, in relation to the average net outstanding finance receivables for the period being reviewed. Historically, management has found that this methodology has provided an adequate allowance due to the Company’s loan portfolio segments consisting of a large number of smaller balance homogeneous finance receivables. Further, management routinely evaluates the inherent risks and change in the volume and composition of the Company’s finance receivable portfolio based on its extensive experience in the consumer finance industry in consideration of estimating the adequacy of the allowance. Also considered are delinquency trends, economic conditions, and industry factors. Provisions for credit losses are charged to income in amounts sufficient to maintain an allowance for credit losses at a level considered adequate to cover the probable loss inherent in the finance receivable portfolio. Since the estimates used in determining the allowance for credit losses are influenced by outside factors, such as consumer payment patterns and general economic conditions, there is uncertainty inherent in these estimates, making it reasonably possible that they could change. Interest on past due finance receivables is recognized until charge-off. Finance receivables are generally charged off when they are five months contractually past due.
Policy Claim Reserves: Policy claim reserves represent (i) the liability for losses and loss-adjustment expenses related to credit property insurance and (ii) the liabilities for future policy benefits related to credit life and accident and health insurance. The liability for loss and loss adjustment expenses includes an amount determined from loss reports and individual cases and an amount based on past experience, for losses incurred but not reported. The liabilities for future policy benefits have been computed utilizing accepted actuarial techniques. Such liabilities are necessarily based on estimates and, while management believes that the amount is adequate, the ultimate liability may be in excess of or less than the amounts provided. The methods for making such estimates and for establishing the resulting liabilities are continually reviewed, and any adjustments are reflected in earnings currently.
Reinsurance Receivable: The Company has reduced its exposure relating to credit accident and health insurance through a quota share reinsurance agreement. Amounts recoverable from the reinsurer are estimated in a manner consistent with the claim liability associated with the reinsured policy.
Effective December 31, 2012, the reinsurance agreement was terminated for all new business. The receivable will be fully recovered when unearned premiums on the ceded policies reaches $0.

First Tower Finance Company LLC and Subsidiaries
(formerly First Tower Holdings LLC)

Notes to Consolidated Financial Statements

Note 1. Nature of Business and Significant Accounting Policies (Continued)

Income Taxes: First Tower Holdings LLC and its finance company subsidiaries are limited liability companies organized as partnerships for federal and state tax purposes and are not considered taxable entities. Taxable income or loss is reported by the Company's members on their respective tax returns in accordance with the limited liability agreement.

American Federated Holding Company and its wholly-owned subsidiaries, AFIC and AFLIC, are subject to income taxes at the corporate level. As such, deferred income taxes are provided for temporary differences between financial statement carrying amounts of assets and liabilities and their respective bases for income tax purposes using enacted tax rates in effect in the years in which the differences are expected to reverse.

Potential exposures involving tax positions taken that may be challenged by taxing authorities contain assumptions based upon past experiences and judgments about potential actions by taxing jurisdictions. Management does not believe that the ultimate settlement of these items will result in a material amount. Because 2012 was the first taxable year for the Company's limited liability companies, 2012 and subsequent years are subject to income tax examinations. With minimum exceptions, AFIC and AFLIC are no longer subject to income tax examinations prior to 2011.

Cash and Cash Equivalents: For purposes of the consolidated statements of cash flows, the Company considers certificates of deposit and all short-term securities with original maturities of three months or less to be cash equivalents.

Fair Value Disclosures of Financial Instruments: The following methods and assumptions were used by the Company to estimate the fair value of each class of financial instruments:

Cash and Cash Equivalents: The carrying amounts reported in the consolidated balance sheets for these financial instruments approximate their fair values.

Investment Securities: The fair value of investments in trading securities and securities available for sale are generally obtained from independent pricing services based upon valuations for similar assets in active markets or other inputs derived from objectively verifiable information.

Finance Receivables: The fair value of finance receivables approximates the carrying value since the estimated life, assuming prepayments, is short-term in nature.

Other Receivables and Payables: The carrying amounts reported in the consolidated balance sheets approximate their fair values.

Notes Payable: The carrying amounts of borrowings under the line-of-credit agreements reported in the consolidated balance sheets approximate their fair values as the interest charged for these borrowings fluctuate with market changes.

Subordinated Notes Payable to Members: The estimated fair value of subordinated notes payable to members was estimated using discounted cash flow analysis.

Comprehensive Income: Comprehensive income for the Company consists of net earnings and changes in unrealized gains on investment securities classified as available-for-sale, net of taxes, and are presented in the consolidated statements of income and comprehensive income.

First Tower Finance Company LLC and Subsidiaries
(formerly First Tower Holdings LLC)

Notes to Consolidated Financial Statements

Note 1. Nature of Business and Significant Accounting Policies (Continued)
Advertising: Advertising costs are expensed as incurred. Advertising expenses approximated $4,909,000 and $4,912,000 for the years ended December 31, 2014 and 2013, respectively.
Share-Based Compensation: The Company entered into employment agreements with certain executives and, in connection therewith, granted member interests consisting of Class D share awards which vest over a ten year period. Compensation expense for these awards is determined based on the estimated fair value of the shares awarded on the applicable grant or award date, June 14, 2012, and is recognized over the applicable award's vesting period.
Subsequent events: The Company has evaluated its subsequent events (events occurring after December 31, 2014) through March 31, 2015, which represents the date the financial statements were available to be issued.
Effects of Recent Accounting Guidance: In January 2014, the FASB issued ASU 2014-04, "Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure (a consensus of the FASB Emerging Issues Task Force)" which clarifies when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan. This ASU states that a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure, or the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. This new guidance is effective beginning for annual periods beginning after December 15, 2014, and may be applied using either a modified retrospective transition method or a prospective transition method as described in ASU 2014-04. The adoption of this ASU is not expected to have a material effect on the Company's consolidated financial statements.
In May 2014, the Financial Accounting Standard Board (FASB) issued Accounting Standards Update (ASU) 2014-09, "Revenue from Contracts with Customers (Topic 606)." ASU 2014-09 implements a common revenue standard that clarifies the principles for recognizing revenue. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve that core principle, an entity should apply the following steps: (i) identify the contract(s) with a customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract and (v) recognize revenue when (or as) the entity satisfies a performance obligation. ASU 2014-09 is effective for the Company on January 1, 2018. The Company is still evaluating the potential impact on the Company's consolidated financial statements.
In June 2014, the FASB issued ASU 2014-11, "Transfers and Servicing (Topic 860)." ASU 2014-11 requires that repurchase-to-maturity transactions be accounted for as secured borrowings consistent with the accounting for other repurchase agreements. In addition, ASU 2014-11 requires separate accounting for repurchase financings, which entails the transfer of a financial asset executed contemporaneously with a repurchase agreement with the same counterparty. ASU 2014-11 requires entities to disclose certain information about transfers accounted for as sales in transactions that are economically similar to repurchase agreements. In addition, ASU 2014-11 requires disclosures related to collateral, remaining contractual tenor and of the potential risks associated with repurchase agreements, securities lending transactions and repurchase-to-maturity transactions. ASU 2014-11 is effective for the Company on January 1, 2015 and is not expected to have a significant impact on the Company's consolidated financial statements.

First Tower Finance Company LLC and Subsidiaries
(formerly First Tower Holdings LLC)

Notes to Consolidated Financial Statements

Note 1. Nature of Business and Significant Accounting Policies (Continued)
In January 2015, the FASB issued ASU 2015-01, “Income Statement - Extraordinary and Unusual Items (Subtopic 225-20) - Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items.” ASU 2015-01 eliminates from U.S. GAAP the concept of extraordinary items, which, among other things, required an entity to segregate extraordinary items considered to be unusual and infrequent from the results of ordinary operations and show the item separately in the income statement, net of tax, after income from continuing operations. ASU 2015-01 is effective for the Company beginning January 1, 2016, though early adoption is permitted. ASU 2015-01 is not expected to have a significant impact on the Company’s consolidated financial statements.
Note 2. Investment Securities
The cost or amortized cost of securities available for sale and their fair values at December 31, 2014 and 2013 were as follows:

December 31, 2014	Cost or Amortized Cost	Fair Value	Gross Unrealized Gains	Gross Unrealized Losses
Debt securities:				
U.S. Government agencies and corporations	$7,039,353	$7,115,145	$ 79,820	$ 4,028
Obligations of states and political subdivisions	26,750,006	27,132,906	454,713	71,813
Corporate securities	15,707,027	15,812,756	140,010	34,281
Residential mortgage-backed securities	771,286	779,264	7,978	—
Commercial mortgage-backed securities	713,606	701,874	—	11,732
Other loan-backed and structured securities	400,582	400,306	—	276
Total investment securities	$51,381,860	$51,942,251	$ 682,521	$ 122,130
December 31, 2013				
Debt securities:				
U.S. Government agencies and corporations	$7,612,186	$7,440,515	$ 3,953	$ 175,624
Obligations of states and political subdivisions	26,151,621	25,860,654	125,159	416,126
Corporate securities	14,745,737	14,763,422	118,145	100,460
Residential mortgage-backed securities	756,473	731,087	—	25,386
Commercial mortgage-backed securities	749,002	740,973	2,271	10,300
Total investment securities	$50,015,019	$49,536,651	$ 249,528	$ 727,896

As of December 31, 2014 and 2013, accumulated other comprehensive income (loss) includes unrealized gains (losses) on available for sale securities, net of income tax effects, of approximately $330,000 and ($304,000), respectively.

First Tower Finance Company LLC and Subsidiaries
(formerly First Tower Holdings LLC)

Notes to Consolidated Financial Statements

Note 2. Investment Securities (Continued)

The length of time impaired available-for-sale securities have been held in a loss position are as follows:

	Less than 12 months		12 months or more		Total	
December 31, 2014	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Government agencies and corporations	$1,779,646	$3,734	$500,702	$294	$2,280,348	$4,028
Obligations of states and political subdivisions	933,380	1,571	1,946,507	70,242	2,879,887	71,813
Corporate securities	4,248,109	12,794	2,587,369	21,487	6,835,478	34,281
Commercial mortgage-backed securities	260,296	1,438	441,578	10,294	701,874	11,732
Other loan-backed and structured securities	400,306	276	—	—	400,306	276
Total	$7,621,737	$19,813	$5,476,156	$102,317	$13,097,893	$122,130
December 31, 2013						
U.S. Government agencies and corporations	$3,115,552	$22,541	$1,958,318	$153,083	$5,073,870	$175,624
Obligations of states and political subdivisions	13,854,644	298,337	1,569,119	117,789	15,423,763	416,126
Corporate securities	5,526,887	85,748	664,537	14,712	6,191,424	100,460
Residential mortgage-backed securities	731,086	25,386	—	—	731,086	25,386
Commercial mortgage-backed securities	467,227	10,300	—	—	467,227	10,300
Total	$23,695,396	$442,312	$4,191,974	$285,584	$27,887,370	$727,896

Substantially all gross unrealized losses at December 31, 2014 and 2013 were attributable to interest rate changes rather than an adverse change in cash flows or a fundamental weakness in the credit quality of the issuer or the underlying assets and are thus considered temporarily impaired. Due to the issuers' continued satisfaction of the securities' obligations in accordance with contractual terms, the expectation that they will continue to do so and the Company's intent and ability to hold these investments, management believes the securities in unrealized loss positions are temporarily depressed. As of December 31, 2014 the Company had 65 debt securities with temporary impairments, including 11 U.S. government securities, 15 securities classified as obligations of state and political subdivisions, 35 securities classified as corporate securities, and 4 investment classified as commercial mortgage-backed securities. As of December 31, 2013 the Company had 127 debt securities with temporary impairments, including 10 U.S. government securities, 69 securities classified as obligations of state and political subdivisions, 43 securities classified as corporate securities, 3 investments classified as residential mortgage-backed securities and 2 investments classified as commercial mortgage-backed securities.

Management of the Company evaluates securities for other-than-temporary impairment ("OTTI") no less than annually or when economic or market concerns warrant such evaluation. The evaluation is based upon factors such as the creditworthiness of the issuer, the underlying collateral, if applicable, and the continuing performance of the securities. Management also evaluates other facts and circumstances that may be indicative of an OTTI condition. This includes, but is not limited to, an evaluation of the type of security, length of time and extent to which the fair value has been less than cost, and near-term prospects of the issuer.

First Tower Finance Company LLC and Subsidiaries
(formerly First Tower Holdings LLC)

Notes to Consolidated Financial Statements

Note 2. Investment Securities (Continued)
The Company segregates the OTTI impact on impaired securities where impairment in value was deemed to be other than temporary between the component representing credit loss and the component representing loss related to other factors.
The Company assesses whether a credit loss exists by considering whether (i) the Company has the intent to sell the security, (ii) it is more likely than not that it will be required to sell the security before recovery, or (iii) it does not expect to recover the entire amortized cost basis of a debt security. The portion of the fair value decline attributable to credit loss is recognized as a charge to earnings. The credit loss evaluation is determined by comparing the present value of the cash flows expected to be collected, discounted at the rate in effect before recognizing any OTTI with the amortized cost basis of the debt security. The Company uses the cash flow expected to be realized from the security, which includes assumptions about interest rates, timing and severity of defaults, estimates of potential recoveries, the cash flow distribution from the bond indenture and other factors, then applies a discount rate equal to the effective yield of the security. The difference between the present value of the expected cash flows and the amortized book value is considered a credit loss. The difference between the fair market value and the security's remaining amortized cost is recognized in other comprehensive income or loss.
The amortized cost and fair value of debt securities at December 31, 2014, by contractual maturity, is shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepay penalties.

December 31, 2014	Cost or Amortized Cost	Fair Value
Due in one year or less	$6,498,538	$6,505,171
Due after one year but less than five years	20,893,496	21,030,923
Due after five years but less than ten years	21,381,410	21,794,775
Due after ten years	722,942	729,938
Residential mortgage-backed securities	771,286	779,264
Commercial mortgage-backed securities	713,606	701,874
Other loan-backed and structured securities	400,582	400,306
Total debt securities	$51,381,860	$51,942,251

Investment securities with amortized cost of approximately $3,063,000 and with estimated fair values of $3,070,000 at December 31, 2014, were pledged by the Company with various states as required by state law. Investment securities with amortized cost of approximately $3,057,000 and with estimated fair values of $3,080,000 at December 31, 2013, were pledged by the Company with various states as required by state law.

First Tower Finance Company LLC and Subsidiaries
(formerly First Tower Holdings LLC)

Notes to Consolidated Financial Statements

Note 2. Investment Securities (Continued)

Major categories of net investment income are summarized as follows for the year ended December 31, 2014 and 2013:

December 31,	2014	2013
Debt securities	$883,487	$721,447
Common stocks	122,744	202,265
Mortgage and collateral loans	7,800	7,800
Cash and short-term investments	509	457
	1,014,540	931,969
Investment expenses	(177,792)	(161,198)
Net investment income	$836,748	$770,771

Net realized investment gains are summarized as follows for the year ended December 31, 2014 and 2013:

December 31,	2014	2013
Gross realized gains on sale of securities available for sale	$34,363	$14,910
Gross realized losses on sale of securities available for sale	(86,185)	(46,549)
Gain (loss) from investments in trading securities	(2,120)	142,476
Net realized investment gains (losses)	$(53,942)	$110,837

Proceeds from sales of investment securities available for sale aggregated approximately $7,480,000 and $5,794,000 for the years ended December 31, 2014 and 2013, respectively.

Note 3. Finance Receivables

Finance receivables were as follows:

December 31,	2014	2013
Consumer finance receivables:		
Personal property	$496,914,298	$476,832,230
Real estate	34,630,530	43,665,858
Sales finance	117,697,434	102,659,880
	649,242,262	623,157,968
Add (deduct):		
Net deferred origination costs	5,350,272	4,381,480
Unearned income	(177,266,473)	(164,182,157)
Unearned discount on acquired loans	(1,262,484)	(9,242,643)
Allowance for credit losses	(44,668,180)	(32,804,985)
Finance receivables, net	$431,395,397	$421,309,663

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First Tower Finance Company LLC and Subsidiaries
(formerly First Tower Holdings LLC)

Notes to Consolidated Financial Statements

Note 3. Finance Receivables (Continued)

Changes in the allowance for credit losses were as follows during the year ended December 31, 2014 and 2013:

December 31,	2014	2013
Balance at beginning of year	$(32,804,985)	$(13,324,265)
Provision for credit losses	(56,186,665)	(59,937,057)
Receivables charged-off	57,641,988	52,562,233
Charge-offs recovered	(13,318,518)	(12,105,896)
Balance at end of year	$(44,668,180)	$(32,804,985)

The balance in the allowance for credit losses by portfolio segment at December 31, 2014 and 2013 was as follows:

December 31, 2014	Balance at Beginning of Period	Charge-offs	Recoveries	Provision for Credit Losses	Balance at End of Period	Finance Receivables at End of Period	Allowance as Percentage of Finance Receivables at End of Period
Personal Property	$31,182,545	$(54,309,913)	$12,559,363	$53,093,822	$42,525,817	$369,688,435	11.5 %
Real Estate	199,938	(513,329)	40,455	501,451	228,515	23,553,939	1.0 %
Sales Finance	1,422,502	(2,818,746)	718,700	2,591,392	1,913,848	77,470,931	2.5 %
Total loans	$32,804,985	$(57,641,988)	$13,318,518	$56,186,665	$44,668,180	$470,713,305	9.5 %
December 31, 2013							
Personal Property	$12,535,995	$(49,610,961)	$11,355,276	$56,902,235	$31,182,545	$353,542,477	8.8 %
Real Estate	145,641	(422,774)	58,864	418,207	199,938	27,954,965	0.7 %
Sales Finance	642,629	(2,528,498)	691,756	2,616,615	1,422,502	68,235,726	2.1 %
Total loans	$13,324,265	$(52,562,233)	$12,105,896	$59,937,057	$32,804,985	$449,733,168	7.3 %

First Tower Finance Company LLC and Subsidiaries
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Notes to Consolidated Financial Statements

Note 3. Finance Receivables (Continued)

The Company classifies delinquent accounts based upon the number of contractual installments past due. An aging of delinquent gross finance receivables as of December 31, 2014 and 2013 is as follows:

December 31, 2014	Current	Past Due 30-90 Days	Past Due 91-150 Days	Past Due Greater Than 150 Days	Total
Personal Property	$439,980,023	$44,222,982	$12,708,607	$2,686	$496,914,298
Real Estate	30,854,113	2,992,238	261,914	522,265	34,630,530
Sales Finance	113,782,755	3,190,905	714,992	8,782	117,697,434
Gross Finance Receivables	$584,616,891	$50,406,125	$13,685,513	$533,733	$649,242,262
December 31, 2013					
Personal Property	$415,630,566	$47,439,548	$13,759,974	$2,142	$476,832,230
Real Estate	38,485,840	4,522,937	591,422	65,659	43,665,858
Sales Finance	98,857,928	3,054,278	723,329	24,345	102,659,880
Gross Finance Receivables	$552,974,334	$55,016,763	$15,074,725	$92,146	$623,157,968

Nonperforming loans consisted of loans past due greater than 150 days and approximated $534,000 and $92,000 at December 31, 2014 and 2013, respectively. Additionally, the Company had gross finance receivables relating to customers in bankruptcy and which the terms of the original contract have been modified approximating $3,810,000 and $4,583,000 at December 31, 2014 and 2013, respectively.

Note 4. Reinsurance

The Company is party to a quota share reinsurance agreement that ceded 40% of its credit accident and health business written prior to January 1, 2013 in order to limit its exposure on credit disability coverages. Reinsurance contracts do not relieve the Company from its primary obligation to policyholders. Failure of any reinsurer to honor its obligations could result in losses to the Company.

The ceded reinsurance agreement contains a retrospective rating provision that results in a favorable adjustment to the reinsurance premiums if certain underwriting results are achieved on the reinsured business during the experience period. The Company estimates the amount of ultimate premium adjustment that the Company may earn upon completion of the experience period and recognizes an asset for the difference between the initial reinsurance premiums paid and the estimated ultimate premium. The Company adjusts such estimated ultimate premium amounts during the course of the experience period based on actual results to date. The resulting adjustment is recorded as either a reduction of or an increase to the ceded premiums for the year. Included in reinsurance recoverables at December 31, 2014 and 2013 are estimated receivables relating to the retrospective rating provisions of approximately $1,168,000 and $1,215,000, respectively. During the years ended December 31, 2014 and 2013 ceded premiums have been reduced by retrospective premium adjustments of approximately $217,000 and $482,000, respectively.

First Tower Finance Company LLC and Subsidiaries
(formerly First Tower Holdings LLC)

Notes to Consolidated Financial Statements

Note 4. Reinsurance (Continued)

The effect of reinsurance on premiums written and earned is as follows for the year end December 31, 2014 and 2013:

December 31, 2014	Written	Earned
Direct	$33,083,850	$30,666,460
Ceded	470,682	470,682
Net premiums	$33,554,532	$31,137,142
December 31, 2013		
Direct	$30,256,508	$22,190,544
Ceded	1,422,979	1,422,979
Net premiums	$31,679,487	$23,613,523

Note 5. Property and Equipment

Property and equipment at December 31, 2014 and 2013 is as follows:

	Estimated Useful Lives	December 31, 2014	December 31, 2013
Land		$408,188	$307,320
Building and improvements	15 to 40 years	2,868,338	2,104,397
Office furniture and fixtures	5 to 10 years	1,591,073	1,161,970
Data processing equipment	3 years	8,298,217	4,559,523
Automotive equipment	3 years	1,510,648	1,328,411
Leasehold improvements	5 years	1,596,903	1,215,642
		16,273,367	10,677,263
Less accumulated depreciation		4,433,861	2,113,599
Property and equipment, net		$11,839,506	$8,563,664

Depreciation expense for the years ended December 31, 2014 and 2013 approximated $2,500,000 and $1,557,000, respectively.

Note 6. Goodwill and Intangible Assets

A summary of goodwill and its estimated finite life is as follows:

	Estimated Useful Lives	December 31, 2014	December 31, 2013
Goodwill	10 years	$136,176,452	$136,176,452
Less accumulated amortization		27,235,292	13,617,645
Goodwill, net		$108,941,160	$122,558,807

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First Tower Finance Company LLC and Subsidiaries
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Notes to Consolidated Financial Statements

Note 6. Goodwill and Intangible Assets (Continued)

A summary of the other intangible assets and their estimated finite lives were as follows:

	Estimated Useful Lives	December 31, 2014	December 31, 2013
Trade names	5 to 15 years	$24,400,000	$24,400,000
Non-competition and license agreements	2 to 4 years	2,323,800	2,323,800
Internally developed technology	2 years	1,000,000	1,000,000
Customer relationships and other	2 to 3 years	488,700	488,700
		28,212,500	28,212,500
Less accumulated amortization		7,442,922	4,828,324
Intangible assets, net		$20,769,578	$23,384,176

Aggregate amortization expense for goodwill and intangible assets for the year ended December 31, 2014 approximated $13,618,000 and $2,615,000, respectively. Aggregate amortization expense for goodwill and intangible assets for the year ended December 31, 2013 approximated $13,618,000 and $3,070,000, respectively. The estimated amortization expense of goodwill and the finite-lived intangible assets for future years is summarized as follows:

2015	$15,718,131
2016	15,456,187
2017	15,251,812
2018	15,224,312
2019	15,224,312
Thereafter	52,835,983
Total	$129,710,738

Note 7. Notes Payable and Credit Arrangements for Business Operations

On June 15, 2012, the Company entered into a new revolving loan agreement to provide for a total credit facility of up to $400,000,000 which terminates on June 15, 2016. Borrowings are limited to a borrowing base as defined in the related agreement. This agreement was amended during 2014 to allow for the issuance of the subordinated notes payable as described in Note 8.

Borrowings under the revolving loan agreement bear interest at an annualized referenced rate equal to the higher of (i) the federal funds rate plus 0.50%, (ii) the lenders prime rate, or (iii) LIBOR plus 1%, and adjusted for an applicable margin based upon the current borrowing availability. The applicable margin ranges from 1.50% to 3.00% depending on the reference rate and borrowing availability percentage as defined in the agreement. Borrowings are collateralized by substantially all of the Company’s consumer finance assets, including all finance receivables and intangibles.

The loan agreement contains covenants which place restrictions on the Company, including limitations on distributions, additional indebtedness, transactions with affiliates, and require that certain minimum interest coverage and senior debt leverage ratios be maintained. At December 31, 2014 and 2013, the Company was in compliance with the covenants.

First Tower Finance Company LLC and Subsidiaries
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Notes to Consolidated Financial Statements

Note 7. Notes Payable and Credit Arrangements for Business Operations (Continued)

In addition, the Company has a $7,000,000 revolving line of credit with a bank which expires June 30, 2016. Advances under the line of credit bear interest at one-month LIBOR plus 2.75% with a floor rate of 3.75%, adjusted monthly, and are collateralized by all of the outstanding shares of American Federated Life Insurance Company and certain deeds of trust.

At December 31, 2014 and 2013, the amount outstanding under the revolving loan agreement was approximately $285,500,000 and $271,759,000, respectively, with an average effective interest rate of 3.78% and 3.93%, respectively. The amount outstanding under the revolving line of credit with the bank was approximately $5,998,000 with an interest rate of 3.80% at December 31, 2014 and $5,141,000 with an interest rate of 3.80% at December 31, 2013. Interest is payable monthly.

Note 8. Subordinated Notes Payable to Members

On June 24, 2014, First Tower, LLC (“FT LLC”) issued subordinated term loan notes payable to the members of the Company in the aggregate amount of $313,844,000 pursuant to a subordinated loan agreement (the “Subordinated Loan Agreement”). The proceeds of the subordinated term loans were distributed to the Company, which were then distributed to its members as a return of capital.

Under the terms of the Subordinated Loan Agreement, these subordinated term loans bear interest at a rate per annum equal to 10% plus a paid-in-kind rate (the “PIK Rate”) of 7%. Effective October 1, 2014, the PIK Rate was increased to 12%. Interest accruing at the 10% rate is payable monthly in cash and the PIK Rate interest is payable monthly in cash, at FT LLC’s option, subject to certain restrictions as specified by the terms of a subordination and intercreditor agreement with lenders of the Company’s credit facility and revolving line of credit (See Note 7). Accruing PIK Rate interest that may be prohibited from being paid currently under the subordination and intercreditor agreement as a result of distributable income limitations from operating subsidiaries is automatically added to the principal of the subordinated term loan notes.

The subordinated term loan notes mature on the earlier of June 24, 2019 or six months after the termination of the Company’s credit facility. Subject to the subordination and intercreditor agreement, FT LLC may prepay in whole or in part amounts outstanding. However, any amounts prepaid prior to the third anniversary of the issuance would be subject to a prepayment premium ranging from 1% - 3% depending on the timing of the prepayment. FT LLC’s obligations under the subordinated term loan notes are secured by a lien granted to Prospect Capital Corporation as collateral agent for the benefit of the holders of the subordinated term loan notes against all of the LLC interests of its wholly-owned finance company subsidiaries and all other First Tower, LLC assets.

The Subordinated Loan Agreement contains various provisions which require FT LLC to make mandatory prepayments, subject to specified exceptions, with the proceeds of asset dispositions, debt and specified equity issuances, changes of control, and certain other events. In addition to other covenants, the Subordinated Loan Agreement places limits on FT LLC and its subsidiaries’ ability to declare dividends or redeem or repurchase capital stock, prepay, redeem or purchase debt, incur liens and engage in sale-leaseback transactions, make loans and investments, incur additional indebtedness, amend or otherwise alter debt and other material agreements, make capital expenditures, engage in mergers, acquisitions and asset sales, transact with affiliates and alter its business. Further, the Subordinated Loan Agreement contains events of default, including cross defaults under other debt obligations of the Company.

At December 31, 2014, the principal amount outstanding of the subordinated term loan notes payable was $313,844,000. During 2014, paid-in-kind interest of $1,113,196 was added to the principal of the subordinated term loan notes payable and repaid. Interest expense, including PIK Rate interest, incurred on the subordinated term loan notes approximated $32,203,000 during 2014.

Explanation of Responses:

First Tower Finance Company LLC and Subsidiaries
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Notes to Consolidated Financial Statements

Note 9. Policy Claim Liabilities

Activity in policy claim reserves, including claim adjustment expenses for the year ended from December 31, 2014 and 2013, is summarized as follows:

December 31,	2014	2013
Balance at beginning of year	$2,524,084	$2,571,538
Less reinsurance recoverables	413,045	674,746
Net balance at beginning of year	2,111,039	1,896,792
Incurred related to:		
Current period	5,731,101	5,547,196
Prior years	(546,238)	(441,490)
Total incurred	5,184,863	5,105,706
Paid related to:		
Current period	3,586,918	3,589,178
Prior years	1,380,266	1,302,281
Total paid	4,967,184	4,891,459
Net balance at end of year	2,328,718	2,111,039
Plus reinsurance recoverables	58,149	413,045
Balance at end of year	$2,386,867	$2,524,084

Note 10. Income Taxes

The Company's insurance subsidiaries file income tax returns in the U. S. federal jurisdiction and in the states in which they operate. The multiple state tax jurisdictions in which the insurance subsidiaries operate require the appropriate allocation of income and expense to each state based on a variety of apportionment or allocation bases.

The provisions for income taxes of the Company's insurance subsidiaries for the year ended December 31, 2014 and 2013 consisted of the following:

December 31,	2014	2013
Current benefit	$(17,547)	$—
Deferred expense	450,495	1,527,828
Provision for income taxes	$432,948	$1,527,828

The Company did not have unrecognized tax benefits as of December 31, 2014 and does not expect this to change significantly over the next 12 months. It is the Company's policy to recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. As of December 31, 2014, the Company had no accrued interest or penalties related to uncertain tax positions.

First Tower Finance Company LLC and Subsidiaries
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Notes to Consolidated Financial Statements

Note 10. Income Taxes (Continued)

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes relating to the Company's insurance subsidiaries. The tax effects of significant items comprising the Company's net deferred tax liability and asset were as follows:

	December 31, 2014	December 31, 2013
Deferred tax assets:		
Policy claim reserves and unearned premiums	$2,170,553	$2,172,755
Goodwill and intangible assets	551,579	—
Net operating and capital losses carryforward	1,492,501	1,952,934
Unrealized holding loss on available for sale securities	—	180,703
	4,214,633	4,306,392
Valuation allowance	—	—
	4,214,633	4,306,392
Deferred tax liabilities:		
Reinsurance recoverables	323,269	249,152
Goodwill and intangible assets	—	43,101
Deferred acquisition costs	7,459,096	6,949,882
Unrealized holding gain on trading securities	67,237	68,028
Unrealized gain on securities available for sale	196,443	—
	8,046,045	7,310,163
Deferred tax liabilities, net	$(3,831,412)	$(3,003,771)

First Tower Finance Company LLC and Subsidiaries
(formerly First Tower Holdings LLC)

Notes to Consolidated Financial Statements

Note 10. Income Taxes (Continued)

The provision for income taxes differs from the amount computed by applying the federal statutory rate of 35% to income before income taxes as follows:

December 31,	2014	2013
Consolidated income before taxes	$17,364,544	$43,397,855
Less: non-taxable entities	16,257,002	44,169,728
Income before taxes from taxable entities	$1,107,542	$(771,873)
Tax based on federal statutory rate	$376,564	$(262,437)
Mark to market adjustments	251,388	2,394,521
Non taxable interest income	(176,917)	(176,948)
State income taxes and other	(14,914)	38,990
Adjustment to prior year taxes	16,021	(430,104)
Transactional costs	(230,269)	(247,269)
Goodwill	211,075	211,075
Provision for income taxes	$432,948	$1,527,828

The Company's insurance subsidiaries have approximately $4,258,000 in federal net operating loss carryforwards that will expire in 2032, if not used.

Note 11. Employee Profit Sharing Plan

The Company has a profit sharing plan covering substantially all the Company's employees that includes a 401(k) provision which allows employees to contribute salary subject to the maximum contribution allowed by the IRS. The Company matches 50% of the first 6% of employee contributions. Additional contributions may be made at the discretion of the Company. Profit sharing expense approximated $397,000 and $360,000 for the years ended December 31, 2014 and 2013, respectively.

Note 12. Members Equity

The Company's capital structure consists of four classes of member common units. All classes of common units, except for Class D common units, share in the profits and losses of the Company and in the distributions of member capital on a pro-rata basis in proportion to total number of such units outstanding. The four classes of member common units are as follows:

- Class A common units – These units have voting rights in proportion to the total number of Class A, Class B and Class C common units outstanding. There were 104,530,989 Class A common units issued to members for the value of the contributed assets on June 14, 2012 which remain outstanding as of December 31, 2014 and 2013. Issuance of additional Class A common units in excess of 10% of the fully diluted outstanding units of Class A and Class B common units require the approval of at least 81% of the outstanding Class A common units.
- Class B common units – These units have voting rights in proportion to the total number of Class A, Class B and Class C common units outstanding. There were 39,677 Class B common units issued for cash on June 14, 2012. An additional 19,838 Class B common units were issued for cash on October 1, 2012. As of December 31, 2014 and 2013, there are 59,515 Class B common units outstanding.

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First Tower Finance Company LLC and Subsidiaries
(formerly First Tower Holdings LLC)

Notes to Consolidated Financial Statements

Note 12. Members Equity (Continued)

- Class C common units – These units have voting rights in proportion to the total number of Class A, Class B and Class C common units outstanding. As of December 31, 2014 and 2013, no Class C common units have been issued. These units will be issued upon the conversion of Class D common units.
- Class D common units – These units have no voting rights and are unvested upon issuance. Class D common units vest over a ten year period beginning June 15, 2012 at 10% per year. Unvested Class D common units are forfeited upon the termination of the holder's employment for any reason. Each holder of Class D common units has the right to convert such units to Class C common units at a ratio of four Class D common units for one Class C common unit provided that (i) the date of such conversion occurs no earlier than the 10th anniversary of June 15, 2012, (ii) such holder notifies the Company thirty days prior to conversion, and (iii) the internal rate of return as of the most recent fiscal quarter exceeds a pre-defined minimum. On June 14, 2012, the Company entered into employment contracts with two key executives and, in connection therewith, granted these executives 12,941,176 unvested Class D common units with an estimated fair value at date of grant of approximately $698,000. Compensation expense related to Class D common units approximated $70,000 annually for the years ended December 31, 2014 and 2013.

Members have no power to vote on any matter except matters on which a vote of units is required pursuant to the Company's Operating Agreement. The Operating Agreement provides for, among other things, limitations on the transfer of member units, rights of first refusal, pre-emptive rights, and certain call and put provisions.

Note 13. Statutory Financial Information of Insurance Subsidiaries

Generally accepted accounting principles (GAAP) differ in certain respects from the accounting practices prescribed or permitted by insurance regulatory authorities (Statutory). A reconciliation between net income and stockholder's equity of the Company's insurance subsidiaries as reported under GAAP and Statutory follows as of December 31, 2014 and 2013:

December 31, 2014	Net Income (Loss)	Stockholder's Equity
GAAP basis, including effects of purchase accounting	$675,196	$70,929,278
Adjustments to:		
Non-admitted assets	1,600	(46,529)
Accumulated depreciation	—	55,137
Investment securities and related unrealized gains	505,082	(1,783,268)
Deferred acquisition costs	(1,519,537)	(22,147,866)
Goodwill and intangible assets	4,448,554	(33,858,921)
Policy claim reserves and unearned premiums	353,267	(609,083)
Deferred income taxes and income taxes payable	420,711	10,320,919
Asset valuation and interest maintenance reserves	45,596	(107,354)
Statutory Basis	$4,930,469	$22,752,313

First Tower Finance Company LLC and Subsidiaries
(formerly First Tower Holdings LLC)

Notes to Consolidated Financial Statements

Note 13. Statutory Financial Information of Insurance Subsidiaries (Continued)

December 31, 2013	Net Income (Loss)	Stockholder's Equity
GAAP basis, including effects of purchase accounting	$(2,299,526)	$73,033,267
Adjustments to:		
Non-admitted assets	1,600	(50,270)
Reinsurance receivables	—	55,001
Investment securities and related unrealized gains	424,592	(1,223,560)
Deferred acquisition costs	(6,936,756)	(20,628,322)
Goodwill and intangible assets	4,551,165	(38,310,663)
Policy claim reserves and unearned premiums	6,882,516	(1,017,353)
Deferred income taxes and income taxes payable	1,527,828	5,622,722
Asset valuation and interest maintenance reserves	47,587	(168,820)
Statutory Basis	$4,199,006	$17,312,002

Under state statutes, each of the insurance subsidiaries is required to maintain minimum capital and surplus of $1,500,000.

Insurance regulations limit the amount of dividends that may be paid without approval of the insurance subsidiaries' regulatory agency. At December 31, 2014 and 2013, there were no undistributed earnings and surplus available for future distributions as dividends are not permitted, without the prior approval of the State of Mississippi Insurance Department.

The National Association of Insurance Commissioners (NAIC) measures the adequacy of an insurance company's capital by its risk-based capital ratio (the ratio of its total capital, as defined, to its risk-based capital). The requirements provide a measurement of minimum capital appropriate for an insurance company to support its overall business operations based upon its size and risk profile which considers (i) asset risk, (ii) insurance risk, (iii) interest rate risk, and (iv) business risk. An insurance company's risk-based capital is calculated by applying a defined factor to various statutory-based assets, premiums, and reserve items, wherein the factor is higher for items with greater underlying risk.

The State of Mississippi statutes have provided levels of progressively increasing regulatory action for remedies when an insurance company's risk-based capital ratio falls below a ratio of 2:1. As of December 31, 2014 and 2013 (latest information available), the Company's insurance subsidiaries were in compliance with these minimum capital requirements as follows:

December 31, 2014	AFLIC	AFIC
Total adjusted capital	$10,069,089	$12,760,517
Authorized control level risk-based capital	722,357	2,522,020
Ratio of adjusted capital to risk based capital	13.9:1	5.1:1

December 31, 2013		
Total adjusted capital	$8,139,231	$9,242,097
Authorized control level risk-based capital	646,982	2,959,300
Ratio of adjusted capital to risk based capital	12.6:1	3.1:1

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Explanation of Responses:

First Tower Finance Company LLC and Subsidiaries
(formerly First Tower Holdings LLC)

Notes to Consolidated Financial Statements

Note 14. Leases

The Company leases office facilities under noncancellable operating leases. Rental expense approximated $2,182,000 and $1,909,000 for the years ended December 31, 2014 and 2013, respectively. Future minimum lease payments at December 31, 2014 are as follows:

Fiscal Year 2015	$1,997,745
Fiscal Year 2016	1,695,391
Fiscal Year 2017	1,323,529
Fiscal Year 2018	774,143
Fiscal Year 2019	256,444
Thereafter	104,153
	$6,151,405

Note 15. Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of finance receivables. Concentrations of credit risk with respect to finance receivables are limited due to the large number of customers comprising the Company’s customer base. These finance receivables are mainly from customers located in Mississippi, Louisiana, Alabama, Illinois and Missouri.

At December 31, 2014 and 2013, the Company had funds on deposit with depository and investment institutions in excess of insured limits of approximately $9,849,000 and $5,027,000, respectively.

First Tower Finance Company LLC and Subsidiaries
(formerly First Tower Holdings LLC)

Notes to Consolidated Financial Statements

Note 16. Fair Value Measurements

The fair value measurements by input level at December 31, 2014 and 2013 for assets and liabilities measured at fair value on a recurring basis follow:

December 31, 2014	Total	Level 1	Level 2	Level 3
Trading securities - equity mutual funds	$1,594,391	$1,594,391	$—	$ —
Available-for-sale securities:				
U.S. Government agencies and corporations	7,115,145	6,907,601	207,544	—
Obligations of states and political subdivisions	27,132,906	—	27,132,906	—
Corporate securities	15,812,756	—	15,812,756	—
Residential mortgage-backed securities	779,264	—	779,264	—
Commercial mortgage-backed securities	701,874	—	701,874	—
Other loan-backed and structured securities	400,306	—	400,306	—
	$53,536,642	$8,501,992	$45,034,650	$ —
December 31, 2013				
Trading securities - equity mutual funds	$1,473,768	$1,473,768	$—	$ —
Available-for-sale securities:				
U.S. Government agencies and corporations	7,440,515	7,192,739	247,776	—
Obligations of states and political subdivisions	25,860,654	—	25,860,654	—
Corporate securities	14,763,422	—	14,763,422	—
Residential mortgage-backed securities	731,087	—	731,087	—
Commercial mortgage-backed securities	740,973	—	740,973	—
	$51,010,419	$8,666,507	$42,343,912	$ —

Certain assets and liabilities are potentially measured at fair value on a nonrecurring basis (for example, when there is evidence of impairment). In addition, to the assets and liabilities measured at fair value at date of acquisition (see Note 2), assets measured at fair value on a non-recurring basis include foreclosed assets (upon initial recognition or subsequent impairment), non-financial assets and non-financial liabilities subject to measurement at fair value in the second step of a goodwill impairment test, and intangible assets and other non-financial long-lived assets subject to measurement at fair value for impairment assessment. During the years ended December 31, 2014 and 2013, certain foreclosed real estate assets, upon initial recognition, were remeasured and reported at fair value through a charge-off to the allowance for credit losses based upon the fair value of the foreclosed asset. The fair value of a foreclosed asset, upon initial recognition, is estimated using Level 2 inputs based on observable market data or Level 3 inputs based on customized discounting criteria. Foreclosed assets measured at fair value upon initial recognition during the year ended December 31, 2014 and 2013 were not material.

First Tower Finance Company LLC and Subsidiaries
(formerly First Tower Holdings LLC)

Notes to Consolidated Financial Statements

Note 17. Disclosures About Fair Value of Financial Instruments

The carrying values and approximate fair values of the Company's financial instruments were as follows:

	December 31, 2014		December 31, 2013	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial Assets:				
Cash and cash equivalents	$10,906,825	$10,906,825	$5,821,481	$5,821,481
Trading securities	1,594,391	1,594,391	1,473,768	1,473,768
Investment securities available for sale	51,942,251	51,942,251	49,536,651	49,536,651
Finance receivables - net	431,395,397	431,395,397	421,309,663	421,309,663
Financial Liabilities:				
Notes payable	291,497,668	291,497,668	276,900,091	276,900,091
Subordinated notes payable to members	313,844,000	313,844,000	—	—

Certain financial instruments are not carried at fair value in the accompanying consolidated balance sheets, including receivables, payables and accrued liabilities. The carrying amount of financial instruments not carried at fair value is a reasonable estimate of their fair value because of the generally short periods of time in which these related assets or liabilities are expected to be realized or liquidated, and because they do not present unanticipated credit concerns.

The estimated fair values are significantly affected by assumptions used, principally the timing of future cash flows, the discount rate, judgments regarding current economic conditions, risk characteristics of various financial instruments and other factors. Because assumptions are inherently subjective in nature, the estimated fair values cannot be substantiated by comparison to independent quotes and, in many cases, the estimated fair values could not necessarily be realized in an immediate sale or settlement of the instrument. Potential tax ramifications related to the realization of unrealized gains and losses that would be incurred in an actual sale and/or settlement have not been taken into consideration.

Note 18. Contingencies

As of December 31, 2014, the Company is involved in various legal actions resulting from normal business activities. Many of these actions do not specify an amount of damages. Also, many of these actions are in very early stages of discovery or discovery has not begun. As a result, legal counsel is unable to provide an estimate of the probability or range of potential exposure. However, based on its experience with lawsuits alleging similar claims, management is of the opinion that the resolution of such actions will not result in a material adverse effect on the consolidated financial statements. Accordingly, with respect to these matters, no provision for loss or liability has been provided in the consolidated financial statements.

The Company's insurance subsidiaries are required by law to participate in the guaranty associations of the various states in which they are licensed to do business. The state guaranty associations ensure payment of guaranteed benefits, with certain restrictions, to policyholders of impaired or insolvent insurance companies by assessing all other companies operating in similar lines of business. As a result, the Company is exposed to undeterminable future assessments resulting from the insolvency of other insurers. For the year ended December 31, 2014, the expenses incurred related to guaranty assessments were minimal.

On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act was enacted into law. This act established the Consumer Financial Protection Bureau ("CFPB") as a federal authority responsible for administering and enforcing the laws and regulations for consumer financial products and services. The legislation does not specifically target installment lending and is specifically prohibited from instituting federal usury interest rate caps. However, it is unclear to what extent the CFPB will impact the future regulation of the industry in which the Company operates.

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HARBORTOUCH PAYMENTS, LLC

FINANCIAL STATEMENTS

DECEMBER 31, 2014
UNAUDITED

HARBORTOUCH PAYMENTS, LLC

BALANCE SHEET
DECEMBER 31, 2014
UNAUDITED

Assets	
Current assets:	
Cash	$6,059,898
Accounts receivable, less allowance for doubtful accounts of $97,820	21,948,820
Loans receivable:	
Employee and agent loans receivable (note 1)	518,303
Related party (note 8)	2,526
Prepaid expenses	404,783
Total current assets	28,934,330
Leasehold improvements, software and equipment:	
At cost, less accumulated depreciation of $359,169 (notes 1 and 2)	2,295,582
Other assets:	
Deposits:	
Lease security	55,978
Processing agent (note 1)	611,064
Promotional equipment not in service	2,498,959
Goodwill (note 1)	204,438,721
Intangible assets (note 3)	199,998,032
Total other assets	407,602,754
Total assets (note 5)	$438,832,666

HARBORTOUCH PAYMENTS, LLC

BALANCE SHEET
DECEMBER 31, 2014
UNAUDITED

Liabilities and Members' Equity	
Current liabilities:	
Accounts payable:	
Trade	$18,677,815
Related party (note 8)	58,838
Current portion of residual liability (note 9)	397,126
Current portion of long-term debt (note 5)	5,231,202
Deferred revenue (note 4)	2,941,725
Accrued expenses (notes 1 and 10)	6,396,576
Contingent liability (note 3)	1,311,635
Total current liabilities	35,014,917
Residual liability (note 9)	1,010,974
Long-term debt (note 5)	310,819,175
Deferred revenue (note 4)	6,964,130
Contingent liability (note 3)	1,735,108
Accrued paid-in-kind interest (note 5)	5,744,434
Cumulative preferred distributions (note 11)	4,455,050
Members' equity (note 11)	73,088,878
Total liabilities and members' equity	$438,832,666

See accompanying notes to financial statements

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HARBORTOUCH PAYMENTS, LLC

STATEMENT OF OPERATIONS
FOR THE PERIOD MARCH 27, 2014 (DATE OF INCEPTION)
THROUGH DECEMBER 31, 2014
UNAUDITED

Gross revenues	$205,511,144
Cost of services	148,584,499
Selling, general and administrative expenses	69,631,552
Loss from operations	(12,704,907)
Other income (expense):	
Interest expense (note 5)	(22,428,819)
Transaction costs (notes 1 and 3)	(3,164,429)
Other income (note 4)	352,788
Interest income	15,484
Total other income (expense)	(25,224,976)
Net loss	$(37,929,883)

See accompanying notes to financial statements

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HARBORTOUCH PAYMENTS, LLC

STATEMENT OF MEMBERS' EQUITY
FOR THE PERIOD MARCH 27, 2014 (DATE OF INCEPTION)
THROUGH DECEMBER 31, 2014
UNAUDITED

Balance - March 27, 2014	$—
Capital contributions	121,001,374
Preferred distributions (note 11)	(9,982,613)
Net loss	(37,929,883)
Balance - December 31, 2014	$73,088,878

See accompanying notes to financial statements

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HARBORTOUCH PAYMENTS, LLC

STATEMENT OF CASH FLOWS
FOR THE PERIOD MARCH 27, 2014 (DATE OF INCEPTION)
THROUGH DECEMBER 31, 2014
UNAUDITED

Cash flows from operating activities:	
Cash received from customers	$90,495,302
Cash paid to suppliers and employees	(55,722,862)
Interest paid	(15,856,280)
Interest received	15,484
Net cash provided from operating activities	18,931,644
Cash flows from investing activities:	
Acquisition of substantially all of the assets of MSND, LLC	(34,827,773)
Acquisition of substantially all of the assets of MSI Merchant Holdings, LLC	(148,476,899)
Acquisition of leasehold improvements, software and equipment (net of assets acquired in connection with the acquisition of MSI Merchant Holdings, LLC, United Bank Card, Inc. and United Cash Solutions, Inc.)	(869,116)
Acquisition of deferred origination costs (net of assets acquired in connection with the acquisition of United Bank Card, Inc.)	(5,189,980)
Acquisition of merchant portfolios	(3,977,982)
Increase in employee and agent loans receivable	(183,769)
Increase in accounts payable related party	58,838
Decrease in related party loans receivable	118,633
Net cash used in investing activities	(193,348,048)
Cash flows from financing activities:	
Repayment of debt	(1,694,225)
Proceeds from debt	186,698,090
Contributed capital	1,000,000
Distributions to members	(5,527,563)
Net cash provided from financing activities	180,476,302
Net increase in cash	6,059,898
Cash - March 27, 2014	—
Cash - December 31, 2014	$6,059,898

See accompanying notes to financial statements

HARBORTOUCH PAYMENTS, LLC

STATEMENT OF CASH FLOWS
FOR THE PERIOD MARCH 27, 2014 (DATE OF INCEPTION)
THROUGH DECEMBER 31, 2014
UNAUDITED

Cash flows from operating activities:	
Net loss	$(37,929,883)
Adjustments:	
Depreciation	359,169
Amortization	45,077,459
Accrued paid-in-kind interest	5,744,434
Accrued interest rolled into note balance	828,105
Changes in assets and liabilities (net of assets acquired and liabilities assumed in connection with the transaction with MSI Merchant Services Holding, LLC, MSND, LLC, United Bank Card, Inc., United Cash Solutions, Inc. and Harbortouch Financial, LLC):	
Increase in accounts receivable	(18,345)
Increase in prepaid expenses	(110,838)
Decrease in processing agent deposit	501,541
Decrease in promotional equipment not in service	179,222
Increase in accounts payable	1,647,600
Decrease in accrued expenses	(2,612,019)
Decrease in residual liability	(130,120)
Decrease in sweepstakes liability	(23,018)
Increase in deferred revenue	5,680,644
Decrease in contingent liability	(262,307)
Total adjustments	56,861,527
Net cash provided from operating activities	$18,931,644

See accompanying notes to financial statements

HARBORTOUCH PAYMENTS, LLC

NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2014
UNAUDITED

Note 1 - Nature of Business and Significant Accounting Policies

Nature of Business

Harbortouch Payments, LLC (the "Company") was formed in the State of New Jersey on March 27, 2014. The Company was formed for the purpose of purchasing substantially all of the assets of MSDN Financial, LLC and the outstanding members' interests in MSI Service Holding, LLC along with a contribution of all of the assets and liabilities of United Bank Card, Inc. The transactions were effective March 31, 2014 and the Company began operations at that time.

Harbortouch Payments, LLC provides point-of sale solutions and card-based payment processing services to business merchants located throughout the United States. The Company's facilities are located in Allentown, Pennsylvania and Morrisville, North Carolina.

Cash

The Company maintains its cash with high credit quality financial institutions. The total cash balances are insured by the Federal Deposit Insurance Corporation (FDIC) up to $250,000 per bank. At December 31, 2014, approximately $6,500,000 was in excess of the FDIC insurance limits.

Accounts Receivable

Accounts receivable are primarily comprised of amounts due from the Company's processors from revenues earned, net of related interchange and processing fees. The receivables are typically received within 15-20 days following the end of each month. Accounts are considered past due when payments exceed normal customer payment periods. Amounts deemed uncollectible are written-off in the period that determination is made. As of December 31, 2014, an allowance of $97,820 was recorded.

Employee and Agent Loans Receivable

The Company periodically advances money to agents and employees. The advances at December 31, 2014 amounted to $518,303. The advances are classified as short-term and are deemed fully collectible.

Leasehold Improvements, Software and Equipment

Leasehold improvements, software and equipment are recorded at cost. The Company's policy is to depreciate all leasehold improvements and equipment using the straight-line depreciation method over the estimated useful lives of the assets. Useful lives range from three to fifteen years.

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HARBORTOUCH PAYMENTS, LLC

NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2014
UNAUDITED

Note 1 - Nature of Business and Significant Accounting Policies
Promotional Equipment Not in Service
Promotional equipment not in service represents credit and debit card terminals, point-of-sale systems and electronic cash registers on hand. These items are deployed to merchants under the Company's free equipment program to merchants as new merchant contracts are signed.
Business Combination and Goodwill
Effective April 1, 2014, the Company entered into an asset purchase agreement to acquire substantially all of the assets of MSND Financial, LLC and a membership purchase agreement to acquire all of the outstanding membership interests in MSI Services Holdings, LLC for a total purchase price of $203,670,174, comprised of $183,304,672 in cash and a $20,365,502 seller note payable (fair value of $22,170,000). In addition all of the outstanding equity in United Bank Card, Inc., United Cash Solutions, Inc. and HarborTouch Financial, LLC were contributed to the Company for 46.5% ownership The Company accounted for this acquisition under the purchase method of accounting. The following is the condensed summary of the assets and liabilities acquired:

Current assets	$20,818,125
Other Assets	3,836,264
Deployed equipment	8,910,000
Fixed assets	1,490,000
Total assets	35,054,389
Liabilities	46,388,818
Net assets acquired	(11,334,429)
Cash purchase price	183,304,672
Seller note payable	22,170,000
Fair value of United Bank Card, Inc.	198,895,686
Total purchase price	404,370,358

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HARBORTOUCH PAYMENTS, LLC

NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2014
UNAUDITED

Note 1 - Nature of Business and Significant Accounting Policies
Business Combination and Goodwill

Purchase price in excess of fair value of net assets acquired before the allocation of identified intangible assets	$415,704,787
Merchant relationships	$101,370,000
Developed technology	70,230,000
Trademarks/ Tradenames	18,930,000
Non-competition agreements	3,080,000
In-process research and development	920,000
Leasehold interests	160,000
Goodwill	221,014,787
Total	415,704,787

The Company has elected to early adopt Accounting Standards Update No. 2014-02, allowing for amortization of existing goodwill over a period of 10 years resulting in recognition of goodwill amortization. Amortization is computed using the straight-line method. At December 31, 2014, accumulated amortization related to goodwill amounted to $16,576,109.

As of December 31, 2014, estimated amortization expense for goodwill for each of the five succeeding years is as follows:

Year Ending December 31st:	
2015	$22,101,479
2016	22,101,479
2017	22,101,479
2018	22,101,479
2019	22,101,479

The Company incurred transaction costs totaling $2,897,266 related to this acquisition which are included in net loss.

HARBORTOUCH PAYMENTS, LLC

NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2014
UNAUDITED

Note 1 - Nature of Business and Significant Accounting Policies

Impairment of Long-Lived Assets

The Company periodically evaluates the carrying value of long-lived assets, in relation to the respective projected future undiscounted cash flows, to assess recoverability. An impairment loss is recognized if the sum of the expected net cash flows is less than the carrying amount of the long-lived assets being evaluated. The difference between the carrying amount of the long-lived assets being evaluated and the fair value, calculated as the sum of the expected cash flows discounted at a market rate, represents the impairment loss.

Reserve for Losses on Merchant Accounts

Disputes between a cardholder and a merchant periodically arise as a result of, among other things, cardholder dissatisfaction with either merchandise quality of merchant services, non-delivery of goods or non-performance of services. Such disputes may not be resolved in the merchant's favor. In these cases, the transaction is "charged back" to the merchant, which means the disputed amount is refunded to the customer through the merchant's acquiring bank and charged to the merchant. If the merchant has inadequate funds, the Company or under limited circumstances, the Company and the acquiring bank, must bear the credit risk for the full amount of the transaction.

The Company maintains deposits from certain merchants as an offset to potential contingent liabilities that are the responsibility of such merchants. The total amount of merchant deposits included in accrued expenses as of December 31, 2014 is $10,000. In addition, the Company's sponsorship banks hold merchant funds that are available to meet merchant chargeback liabilities if the merchant has inadequate funds to meet the obligation. Total merchant funds held at the Company's sponsorship banks totaled approximately $2,823,000 as of December 31, 2014. The Company records a reserve for potential chargeback losses. At December 31, 2014, the reserve for losses on merchant accounts included in accrued expenses totaled $58,216. The Company's transaction processors require the Company to maintain deposits. At December 31, 2014, the total amount of the Company's funds held at transaction processors and included in other assets was $611,064.

HARBORTOUCH PAYMENTS, LLC

NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2014
UNAUDITED

Note 1 - Nature of Business and Significant Accounting Policies
Revenue Recognition and Deferred Revenue
Company revenues are generated from recurring point-of-sale service fees to merchants, as well as fees for card-based payment processing services. Point-of-sale fees are based on the type and quantity of equipment deployed to the merchant, while card-based fees are based on a percentage of sales and the number of transactions processed each month. The Company reports revenues at the time of sale on a gross basis equal to the full amount of the fees charged to the merchant. Revenue is also derived from miscellaneous service fees, including monthly minimum, statement fees, annual fees and other miscellaneous services.
Annual and other fees that relate to multiple months are deferred and recognized as revenue over the respective period the fee covers which is one year or less.
The Company follows the requirements of FASB ASC 605-45-45, Reporting Revenue Gross as a Principal Versus Net as an Agent, in determining revenue reporting. Generally, where the Company has credit risk and ultimate responsibility for the merchant, revenues are reported at the time of sale on a gross basis equal to the full amount of the discount charged to the merchant. This amount includes interchange paid to card issuing banks and assessments paid to credit card companies pursuant to which such parties receive payments based primarily on processing volume for particular groups of merchants. Interchange fees are set by Visa and MasterCard and are based on transaction processing volume and are recognized at the time transactions are processed.
Income Taxes
The Company is organized as a limited liability company in accordance with New Jersey. A limited liability company is not subject to tax in accordance with partnership tax rules. Therefore, there will be no provision for income taxes for this entity since income is taxed on the individual member level.
The Company evaluates uncertain tax positions in accordance with generally accepted accounting principles. The Company’s income tax filings are subject to audit by various taxing authorities. The Company’s open audit periods are 2014.
Advertising Costs
The Company expenses advertising costs as incurred. For the period March 27, 2014 (date of inception) through December 31, 2014 advertising costs were $885,323.

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HARBORTOUCH PAYMENTS, LLC

NOTES TO FINANCIAL STATEMENTS
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Note 1 - Nature of Business and Significant Accounting Policies

Concentrations

The majority of the Company’s merchant processing activity has been processed by two vendors. The Company believes that these vendors maintain appropriate backup systems and alternative arrangements to avoid a significant disruption of the processing in the event of an unforeseen event.

A majority of the Company’s revenue is derived from processing Visa and MasterCard bank card transactions. Because the Company is not a “member bank” as defined by Visa and MasterCard, in order to process these bank card transactions the Company has entered into a sponsorship agreement with a bank. The agreement with the bank sponsor requires, among other things, that the Company abide by the by-laws and regulations of the Visa and MasterCard companies. If the Company breaches the sponsorship agreements, the bank sponsor may terminate the agreement and, under the terms of the agreement, the Company would have 180 days to identify an alternative bank sponsor. The Company is dependent on its bank sponsor, Visa and MasterCard for notification of any compliance breaches.

Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

HARBORTOUCH PAYMENTS, LLC

NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2014
UNAUDITED

Note 2 - Leasehold Improvements, Software and Equipment

The principal categories of leasehold improvements, software and equipment may be summarized as follows:

Leasehold improvements	$722,830
Office equipment	359,735
Capital lease office equipment	293,139
Software	1,002,212
Office furniture and fixtures	276,835
Total cost	2,654,751
Less accumulated depreciation	359,169
Undepreciated cost	$2,295,582

Depreciation expense for the period March 27, 2014 (date of inception) through December 31, 2014 amounted to $359,169.

HARBORTOUCH PAYMENTS, LLC

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Note 3 - Intangible Assets and Contingent Liability

Intangible assets consist of the following:

	Gross Carrying Amount	Accumulated Amortization	Net Book Value	Amortization Life
Merchant relationships	$101,370,000	$12,671,250	$88,698,750	72 Months
Developed technology	70,230,000	5,267,250	64,962,750	120 Months
Trademarks & tradenames	18,930,000	2,839,500	16,090,500	60 Months
Non-Compete agreements	3,080,000	1,155,000	1,925,000	24 Months
In process research and development	920,000	69,000	851,000	120 Months
Leasehold interest	160,000	6,900	153,100	210 Months
Merchant portfolios	16,564,898	1,432,917	15,131,981	36-60 Months
Deferred origination costs	14,099,980	4,640,756	9,459,224	36-60 Months
Loan closing costs	3,144,547	418,820	2,725,727	60 Months
Total	$228,499,425	$28,501,393	$199,998,032	

As of December 31, 2014, estimated amortization expense for intangible assets for each of the five succeeding years is as follows:

Year Ending December 31st:	
2015	$37,757,887
2016	36,312,741
2017	34,695,217
2018	31,052,269
2019	26,028,853

Amortization expense for other intangible assets totaled $28,501,393 for the period March 27, 2014 (date of inception) through December 31, 2014.

Estimated future amortization expense is based on intangible amounts recorded as of December 31, 2014. Actual amounts will increase if additional amortizable assets are acquired.

The Company incurred transaction costs totaling $267,163 related to the acquisition of the merchant portfolio's acquisition which are included in net loss.

The Company has recorded $3,046,743 in contingent liability in relation to the purchase of the merchant portfolios above. Payments of these contingent obligations depend on attrition rates and other financial metrics within the respective merchant portfolios.

HARBORTOUCH PAYMENTS, LLC

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Note 4 - Deferred Revenue
The Company charges merchants annual and PCI fees. These fees related to period of up to one year. The Company defers these and recognizes revenue on them over the period they are respective period earned. As of December 31, 2014, the Company had a total of $1,730,572 in deferred revenue relating to annual and PCI fees. The Company recognized a total of approximately $4,982,239 in revenue is recognized on annual and PCI fees for the period March 27, 2014 (date of inception) through December 31, 2014.
As of December 31, 2014, estimated service contract revenue to be recognized for the next year is $1,730,572.
The Company received a signing bonus as an inducement to enter into a processing agreement. The Company has deferred this revenue and recognizes it over the period of the processing agreement which is seven years. As of December 31, 2014, the Company had a total of $8,175,283 in deferred revenue relating to deferred signing bonus. The Company also received a one-time payment of $50,000 for damages caused by the processors system conversion disruptions. A total of $352,788 in revenue was recognized for signing bonus and damages income for the period March 27, 2014 (date of inception) through December 31, 2014, which is included in other income.
As of December 31, 2014, estimated signing bonus revenue to be recognized for each of the five succeeding years and thereafter is as follows:

Year Ending December 31st:	
2015	$1,211,153
2016	1,211,153
2017	1,211,153
2018	1,211,153
2019	1,211,153
Thereafter	2,119,518

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HARBORTOUCH PAYMENTS, LLC

NOTES TO FINANCIAL STATEMENTS
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Note 5 - Long-Term Debt

Note payable to finance company, quarterly excess cash flow principal payments based on set formula, monthly interest only payments with interest at the greater of 9% or the applicable term loan margin plus the greater of LIBOR or 2% (9% as of December 31, 2014), due September 2017, secured by all assets of the Company and guaranteed by Rook Holdings, Inc.	130,391,816
Convertible debt to finance company, interest only at the greater of 5.5% or the applicable term loan margin plus the greater of LIBOR or 4% (5.5% as of December 31, 2014) plus 5.5% accrued paid in kind, convertible into 535 units of class A equity, due March 2018, secured by all assets of the Company and guaranteed by Rook Holdings, Inc.	137,226,025
Note payable to finance company, monthly excess cash flow principal payments based on set formula, monthly interest only payments with interest at the greater of 13% or the applicable term loan margin plus the greater of LIBOR or 4% (13% as of December 31, 2014), due September 2018, secured by all assets of the Company and guaranteed by Rook Holdings, Inc.	25,196,292
Subordinated seller note payable to former owners of MSI Merchant Services Holdings, LLC and MSND Financials, LLC, interest accrues at 4.85% (face of note at 7%) and compounds semiannually, due March 2018, secured by all assets of the Company	22,998,105
Total this page	315,812,238

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HARBORTOUCH PAYMENTS, LLC

NOTES TO FINANCIAL STATEMENTS
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Note 5 - Long-Term Debt

Total from previous page	$315,812,238
Capital lease payable to financial institution, monthly payment of $7,671, including interest at 2.86%, due September 2017, secured by phone system with a net book value of $249,168	238,139
Total	316,050,377
Less current portion of long-term debt	5,231,202
Total debt reflected as long-term	$310,819,175

The amounts of long-term debt coming due during the four years ending December 31, 2018 are as follows:

2015	$5,231,202
2016	5,238,716
2017	130,960,036
2018	174,620,423

Interest expense for the period March 27, 2014 (date of inception) through December 31, 2014 amounted to $22,428,819.

The Company has agreed to certain loan covenants, including the maintenance of certain financial ratios and restrictions on the level of distributions.

As of December 31, 2014, the Company had a total of $5,744,434 in accrued paid-in-kind interest.

Note 6 - Employee Benefit Plan

The Company maintains a defined contribution plan under Section 401(k) of the Internal Revenue Code covering full-time employees who meet minimum age and service requirements. The provisions of the plan include a corporate discretionary profit-sharing contribution to the plan. There were no discretionary profit-sharing contributions to the plan for the period March 27, 2014 (date of inception) through December 31, 2014.

HARBORTOUCH PAYMENTS, LLC

NOTES TO FINANCIAL STATEMENTS
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Note 7 - Operating Leases

The Company leases its facilities under noncancellable agreements which expire at various dates through December 2018 and require monthly lease payments of $62,017 plus the payment of repairs, maintenance, taxes and insurance. In addition, the Company rents additional warehouse space under month-to-month lease agreements and rents a corporate jet from a related party, see Note 8.

The following are the future minimum rental payments required under the operating leases as of December 31, 2014:

Year Ending December 31st:	
2015	$ 752,227
2016	764,932
2017	561,770
2018	340,990
Total future minimum payments required	2,419,919

Total rental expense included in the determination of net earnings for the period March 27, 2014 (date of inception) through December 31, 2014 amounted to $817,672.

Note 8 - Related Party Transactions

The Company leases an airplane on a month-to-month basis from the shareholder of the Company. Total expense for this lease amounted to $270,000 for the period March 27, 2014 (date of inception) through December 31, 2014.

The Company pays management fees to its shareholders. A total expense for management fees to related parties amounted to $712,500 for the period March 27, 2014 (date of inception) through December 31, 2014.

The Company has a loan receivable from a related party, related through common control. The loan is unsecured and has no repayment terms and is non-interest bearing. The balance due under this loan receivable was $2,526 as of December 31, 2014.

The Company has accounts payable to a related party, related through common control. The balance due as of December 31, 2014 amounted to $58,838.

HARBORTOUCH PAYMENTS, LLC

NOTES TO FINANCIAL STATEMENTS
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Note 9 - Residual Liability

In connection with the Company's sale of the future cash flow rights for its merchant contracts done in prior years, the Company is obligated to pay residual commissions to sales agents on the income from those merchants. The Company recorded the present value of the liability using a discount rate of 13.2%. The residual liability as of December 31, 2014 amounted to $1,408,100.

The expected amounts of residual liability payments coming due during the five years ending December 31, 2019 and thereafter are as follows:

2015	$397,126
2016	368,701
2017	263,294
2018	166,033
2019	103,735
Thereafter	114,211

Note 10 - Litigation

Various legal claims arise from time-to-time in the normal course of business, which, in the opinion of management, will not have a material impact on the Company. As of December 31, 2014 a total of $1,297,847 was accrued for legal settlements and included in accrued expenses.

Note 11 - Members' Equity

The Company has four classes of member's interests. All classes of member's interest earn a preferred return of 11% for which any unpaid balances accrue. Class C and class D member's interest contain voting rights while class A and B contain no voting rights.

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Note 12 - Supplemental Cash Flow Information

During the period March 27, 2014 (date of inception) through December 31, 2014, the Company had the following non-cash transactions.

Deferred revenue of $16,192,134, a merchant portfolio of $12,429,011, loan closing costs of $528,619 and transaction fees of $185,913 were acquired with the assumption of $283,591 in liabilities, a contingent liability of $2,621,145 and term-debt of $26,430,941.

Equipment of $293,139 was acquired with a capital lease payable.

MSND, LLC and MSI Merchant Holdings, LLC were acquired with $22,170,000 in sellers note payable.

Merchant portfolios were acquired with $157,905 in contingent liabilities.

Term-debt of $23,894,312 and distributions of $55,000,000 were funded with $78,894,312 in term-debt.

Contributed capital of $120,001,374 was received in exchange for the assets and liabilities of United Bank Card, Inc., United Cash Solutions, Inc. and HarborTouch Financial, LLC.

Loan closing costs of $2,615,928 was acquired with term-debt.

PROSPECTUS SUPPLEMENT

September 1, 2016

Incapital LLC
BofA Merrill Lynch
Citigroup
RBC Capital Markets