

HFF, Inc.  
Form 10-Q  
November 08, 2013  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**FORM 10-Q**

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

**For the quarterly period ended September 30, 2013**

**OR**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission file number: 001-33280**

**HFF, Inc.**

**(Exact name of registrant as specified in its charter)**

|  |  |
|--|--|
| <b>Delaware</b><br><b>(State of</b>  | <b>51-0610340</b><br><b>(I.R.S. Employer</b> |
| <b>Incorporation)</b>  | <b>Identification No.)</b>                   |
| <b>One Oxford Centre</b><br><b>301 Grant Street, Suite 600</b><br><b>Pittsburgh, Pennsylvania</b><br><b>(Address of Principal Executive Offices)</b> | <b>15219</b><br><b>(Zip code)</b>            |
| <b>(412) 281-8714</b>  |  |
| <b>(Registrant's telephone number, including area code)</b>  |  |

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

|  |   |
|--|---|
| Large accelerated filer <input type="checkbox"/>   | Accelerated filer <input checked="" type="checkbox"/> |
| Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company) | Smaller Reporting Company <input type="checkbox"/>    |

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

Number of shares of Class A common stock, par value \$0.01 per share, of the registrant outstanding as of October 31, 2013 was 37,248,416 shares.

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**HFF, INC. AND SUBSIDIARIES**

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**FORWARD-LOOKING STATEMENTS**

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

**SPECIAL NOTE REGARDING THE REGISTRANT**

In connection with our initial public offering of our Class A common stock in February 2007, we effected a reorganization of our business, which had previously been conducted through HFF Holdings LLC ( HFF Holdings ) and certain of its wholly-owned subsidiaries, including Holliday Fenoglio Fowler, L.P. and HFF Securities L.P. (together, the Operating Partnerships ) and Holliday GP Corp. ( Holliday GP ). In the reorganization, HFF, Inc., a newly-formed Delaware corporation, purchased from HFF Holdings all of the shares of Holliday GP, which is the sole general partner of each of the Operating Partnerships, and approximately 44.7% of the partnership units in each of the Operating Partnerships (including partnership units in the Operating Partnerships held by Holliday GP) in exchange for the net proceeds from the initial public offering and one share of Class B common stock of HFF, Inc. Following this reorganization, HFF, Inc. became and continues to be a holding company holding partnership units in the Operating Partnerships and all of the outstanding shares of Holliday GP. As of August 31, 2012, HFF Holdings had exchanged all of the remaining partnership units in each of the Operating Partnerships for shares of Class A common stock of the Company pursuant to the Exchange Right (as defined in this Quarterly Report on Form 10-Q). As of August 31, 2012 and continuing through the filing date of this Quarterly Report on Form 10-Q, HFF, Inc. through its wholly-owned subsidiaries, holds 100% of the partnership units in the Operating Partnerships and is the only equity holder of the Operating Partnerships. Since all of the partnership units had been exchanged, the Class B common stock was transferred to the Company and retired on August 31, 2012 in accordance with the Company's certificate of incorporation. We refer to these transactions collectively in this Quarterly Report on Form 10-Q as the Reorganization Transactions. Unless we state otherwise, the information in this Quarterly Report on Form 10-Q gives effect to these Reorganization Transactions.

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



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

HFF, Inc.

Consolidated Balance Sheets

*(Dollars in Thousands)**(Current period unaudited)*

|   | September 30,<br>2013 | December 31,<br>2012 |
|---|-----------------------|----------------------|
| <b>ASSETS</b>   |                       |                      |
| Current assets:   |                       |                      |
| Cash and cash equivalents   | \$ 159,268            | \$ 126,331           |
| Accounts receivable   | 3,726                 | 1,784                |
| Receivable from affiliate <i>(Note 16)</i>  |                       | 124                  |
| Mortgage notes receivable <i>(Note 6)</i>   | 6,660                 | 261,272              |
| Prepaid taxes   | 3,112                 | 828                  |
| Prepaid expenses and other current assets   | 3,044                 | 1,749                |
| Deferred tax asset, net   | 3,294                 | 4,052                |
| <br>  |                       |                      |
| Total current assets, net   | 179,104               | 396,140              |
| Property and equipment, net <i>(Note 4)</i>                                       | 6,951                 | 4,800                |
| Deferred tax asset, net   | 158,991               | 165,877              |
| Goodwill  | 3,712                 | 3,712                |
| Intangible assets, net <i>(Note 5)</i>  | 16,868                | 17,899               |
| Other noncurrent assets   | 630                   | 771                  |
| <br>  |                       |                      |
| <b>Total Assets</b>   | <b>\$ 366,256</b>     | <b>\$ 589,199</b>    |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>  |                       |                      |
| Current liabilities:  |                       |                      |
| Current portion of long-term debt <i>(Note 7)</i>                                 | \$ 271                | \$ 299               |
| Warehouse line of credit <i>(Note 8)</i>  | 6,660                 | 261,272              |
| Accrued compensation and related taxes  | 45,460                | 35,597               |
| Accounts payable  | 1,576                 | 1,344                |
| Payable under tax receivable agreement <i>(Note 12)</i>                           | 10,831                | 9,919                |
| Other current liabilities   | 8,015                 | 9,926                |
| <br>  |                       |                      |
| Total current liabilities   | 72,813                | 318,357              |
| Deferred rent credit  | 5,882                 | 4,516                |
| Payable under the tax receivable agreement, less current portion <i>(Note 12)</i> | 134,785               | 145,025              |
| Long-term debt, less current portion <i>(Note 7)</i>                              | 217                   | 279                  |

|   |                   |            |
|---|-------------------|------------|
| Total liabilities   | <b>213,697</b>    | 468,177    |
| Stockholders' equity:   |                   |            |
| Class A common stock, par value \$0.01 per share, 175,000,000 authorized;<br>37,498,796 and 37,221,461 shares issued, respectively; 37,248,416 and<br>37,063,844 shares outstanding, respectively | <b>372</b>        | 371        |
| Treasury stock, 250,380 and 157,617 shares at cost, respectively  | <b>(2,760)</b>    | (1,055)    |
| Additional paid-in-capital  | <b>75,747</b>     | 71,267     |
| Retained earnings   | <b>79,200</b>     | 50,439     |
| <b>Total equity</b>   | <b>152,559</b>    | 121,022    |
| Total liabilities and stockholders' equity  | <b>\$ 366,256</b> | \$ 589,199 |

*See accompanying notes to the consolidated financial statements.*

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HFF, Inc.

## Consolidated Statements of Income

*(Dollars in Thousands, except per share data)**(Unaudited)*

|   | Three Months Ended |                    | Nine Months Ended  |                    |
|---|--------------------|--------------------|--------------------|--------------------|
|   | September 30, 2013 | September 30, 2012 | September 30, 2013 | September 30, 2012 |
| <b>Revenues</b>   |                    |                    |                    |                    |
| Capital markets services revenue                                  | \$ 88,546          | \$ 66,944          | \$ 221,509         | \$ 182,394         |
| Interest on mortgage notes receivable                             | 299                | 1,543              | 1,619              | 3,866              |
| Other   | 569                | 552                | 1,509              | 1,411              |
|   | <b>89,414</b>      | 69,039             | <b>224,637</b>     | 187,671            |
| <b>Expenses</b>   |                    |                    |                    |                    |
| Cost of services  | 49,752             | 40,187             | 131,186            | 110,041            |
| Personnel   | 11,029             | 6,334              | 28,223             | 18,713             |
| Occupancy   | 2,406              | 2,043              | 6,701              | 6,070              |
| Travel and entertainment  | 2,130              | 1,627              | 6,698              | 5,349              |
| Supplies, research, and printing                                  | 1,307              | 1,286              | 3,710              | 4,037              |
| Insurance   | 490                | 499                | 1,478              | 1,357              |
| Professional fees   | 970                | 913                | 2,902              | 2,886              |
| Depreciation and amortization                                     | 1,550              | 1,419              | 5,146              | 4,253              |
| Interest on warehouse line of credit                              | 142                | 1,070              | 977                | 2,550              |
| Other operating   | 993                | 1,330              | 3,682              | 3,862              |
|   | <b>70,769</b>      | 56,708             | <b>190,703</b>     | 159,118            |
| Operating income  | 18,645             | 12,331             | 33,934             | 28,553             |
| Interest and other income, net                                    | 3,546              | 4,407              | 14,157             | 12,543             |
| Interest expense  | (8)                | (11)               | (26)               | (32)               |
| (Increase) decrease in payable under the tax receivable agreement | (701)              | (1,204)            | (1,040)            | (1,213)            |
| Income before income taxes  | 21,482             | 15,523             | 47,025             | 39,851             |
| Income tax expense  | 8,137              | 5,392              | 18,264             | 15,393             |
| Net income  | 13,345             | 10,131             | 28,761             | 24,458             |
| Net income attributable to noncontrolling interest                |                    | 47                 |                    | 243                |
| Net income attributable to controlling interest                   | \$ 13,345          | \$ 10,084          | \$ 28,761          | \$ 24,215          |
| Earnings per share - Basic and Diluted                            |                    |                    |                    |                    |



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|   |         |         |         |         |
|---|---------|---------|---------|---------|
| Income available to HFF, Inc. common stockholders - Basic   | \$ 0.36 | \$ 0.27 | \$ 0.77 | \$ 0.66 |
| Income available to HFF, Inc. common stockholders - Diluted | \$ 0.35 | \$ 0.27 | \$ 0.76 | \$ 0.65 |

*See accompanying notes to the consolidated financial statements.*

**Table of Contents****HFF, Inc.****Consolidated Statements of Stockholders Equity***(Dollars in Thousands, except share data)**(Unaudited)*

|  | Common Stock |        | Controlling Interest<br>Treasury Stock |           | Additional<br>Paid in<br>Capital | Retained<br>Earnings | Noncontrolling<br>Interest | Total<br>Equity |
|--|--------------|--------|--|-----------|----------------------------------|----------------------|----------------------------|-----------------|
|  | Shares       | Amount | Shares                                 | Amount    |                                  |                      |                            |                 |
| Stockholders equity,<br>December 31, 2012                | 37,063,844   | \$ 371 | 157,617                                | \$(1,055) | \$ 71,267                        | \$ 50,439            | \$                         | \$ 121,022      |
| Stock compensation and<br>other, net                     |              |        |  |           | 3,986                            |                      |                            | 3,986           |
| Excess tax benefits from<br>share-based award activities |              |        |  |           | 494                              |                      |                            | 494             |
| Issuance of Class A<br>common stock, net                 | 277,335      | 2      |  |           |                                  |                      |                            | 2               |
| Repurchase of Class A<br>common stock                    | (92,763)     | (1)    | 92,763                                 | (1,705)   |                                  |                      |                            | (1,706)         |
| Net income   |              |        |  |           |                                  | 28,761               |                            | 28,761          |
| Stockholders equity,<br>September 30, 2013               | 37,248,416   | \$ 372 | 250,380                                | \$(2,760) | \$ 75,747                        | \$ 79,200            | \$                         | \$ 152,559      |

|   | Common Stock |        | Controlling Interest<br>Treasury Stock |         | Additional<br>Paid in<br>Capital | Retained<br>Earnings | Noncontrolling<br>Interest | Total<br>Equity |
|---|--------------|--------|--|---------|----------------------------------|----------------------|----------------------------|-----------------|
|   | Shares       | Amount | Shares                                 | Amount  |                                  |                      |                            |                 |
| Stockholders equity,<br>December 31, 2011   | 35,983,965   | \$ 360 | 118,357                                | \$(490) | \$ 64,049                        | \$ 62,914            | \$ 3,567                   | \$ 130,400      |
| Stock compensation and<br>other, net  |              |        |  |         | 3,228                            |                      |                            | 3,228           |
| Issuance of Class A<br>common stock, net (1)  | 1,119,139    | 11     |  |         | 2,753                            |                      | (2,764)                    |                 |
| Repurchase of Class A<br>common stock   | (39,260)     |        | 39,260                                 | (565)   |                                  |                      |                            | (565)           |
| Record the adjustment to<br>give effect of the tax<br>receivable agreement<br>with HFF Holdings |              |        |  |         | 857                              |                      |                            | 857             |
| Distributions   |              |        |  |         |                                  |                      | (1,046)                    | (1,046)         |

|   |            |        |         |           |           |           |     |            |
|---|------------|--------|---------|-----------|-----------|-----------|-----|------------|
| Net income                                  |            |        |         |           |           | 24,215    | 243 | 24,458     |
| Stockholders' equity,<br>September 30, 2012 | 37,063,844 | \$ 371 | 157,617 | \$(1,055) | \$ 70,887 | \$ 87,129 | \$  | \$ 157,332 |

(1) Includes the effect of the exchange of the Operating Partnerships units by HFF Holdings and the effect of the timing of the tax distribution payments on the ownership of the Operating Partnerships.  
*See accompanying notes to the consolidated financial statements.*

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HFF, Inc.

## Consolidated Statements of Cash Flows

*(Dollars In Thousands)**(Unaudited)*

|   | <b>Nine Months Ended September 30,</b> |             |
|---|--|-------------|
|   | <b>2013</b>                            | <b>2012</b> |
| <b>Operating activities</b>   |  |             |
| Net income  | \$ 28,761                              | \$ 24,458   |
| Adjustments to reconcile net income to net cash provided by operating activities: |  |             |
| Stock based compensation  | 6,450                                  | 2,698       |
| Excess tax benefits from share-based award activities                             | (494)                                  |             |
| Deferred taxes  | 7,644                                  | 8,836       |
| Increase in payable under the tax receivable agreement                            | 1,040                                  | 1,213       |
| Depreciation and amortization:  |  |             |
| Property and equipment  | 1,262                                  | 1,490       |
| Intangibles   | 3,885                                  | 2,763       |
| Gain on sale or disposition of assets, net  | (6,684)                                | (6,795)     |
| Mortgage service rights assumed   | (1,569)                                | (1,539)     |
| Proceeds from sale of mortgage servicing rights                                   | 5,425                                  | 3,013       |
| Increase (decrease) in cash from changes in:                                      |  |             |
| Restricted cash   |  | 80          |
| Accounts receivable   | (1,942)                                | (1,277)     |
| Receivable from affiliates  | 124                                    | 115         |
| Payable under the tax receivable agreement  | (10,368)                               | (17,741)    |
| Mortgage notes receivable   | 254,612                                | (77,362)    |
| Net borrowings on warehouse line of credit  | (254,612)                              | 77,362      |
| Prepaid taxes, prepaid expenses and other current assets                          | (3,579)                                | (1,091)     |
| Other noncurrent assets   | 141                                    | 471         |
| Accrued compensation and related taxes  | 7,400                                  | (548)       |
| Accounts payable  | 232                                    | (642)       |
| Other accrued liabilities   | (1,417)                                | (2,300)     |
| Other long-term liabilities   | 1,366                                  | 1,200       |
| Net cash provided by operating activities   | 37,677                                 | 14,404      |
| <b>Investing activities</b>   |  |             |
| Purchases of property and equipment   | (3,272)                                | (1,988)     |
| Net cash used in investing activities   | (3,272)                                | (1,988)     |
| <b>Financing activities</b>   |  |             |
| Payments on long-term debt  | (257)                                  | (249)       |
| Excess tax benefits from share-based award activities                             | 494                                    |             |

|  |            |            |
|--|------------|------------|
| Treasury stock                                 | (1,705)    | (565)      |
| Distributions to noncontrolling interest       |            | (1,046)    |
| Net cash used in financing activities          | (1,468)    | (1,860)    |
| Net increase in cash                           | 32,937     | 10,556     |
| Cash and cash equivalents, beginning of period | 126,331    | 141,763    |
| Cash and cash equivalents, end of period       | \$ 159,268 | \$ 152,319 |

*See accompanying notes to the consolidated financial statements.*

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HFF, Inc.

## Notes to Consolidated Financial Statements

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

HFF, Inc., a Delaware corporation (the Company), through its Operating Partnerships, Holliday Fenoglio Fowler, L.P., a Texas limited partnership (HFF LP), and HFF Securities L.P., a Delaware limited partnership and registered broker-dealer (HFF Securities and together with HFF LP, the Operating Partnerships), is a commercial real estate financial intermediary and provides commercial real estate and capital markets services including debt placement, investment sales, distressed debt and real estate owned advisory services, structured finance, private equity placements, investment banking and capital market advisory services, loan sales and loan sale advisory services and commercial loan servicing in 21 offices in the United States.

**Initial Public Offering and Reorganization**

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

The proceeds of the Offering were used to purchase from HFF Holdings LLC, a Delaware limited liability company (HFF Holdings), all of the shares of Holliday GP Corp. (Holliday GP) and partnership units representing approximately 39% of each of the Operating Partnerships (including partnership units in the Operating Partnerships held by Holliday GP).

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

In addition to cash received for its sale of all of the shares of Holliday GP and approximately 45% of partnership units of each of the Operating Partnerships (including partnership units in the Operating Partnerships held by Holliday GP), HFF Holdings also received, through the issuance of one share of the Company's Class B common stock to HFF Holdings, an exchange right that permitted HFF Holdings to exchange interests in the Operating Partnerships for shares of (i) the Company's Class A common stock (the Exchange Right) and (ii) rights under a tax receivable agreement between the Company and HFF Holdings. See Notes 13 and 12 for further discussion of the Exchange Right held by the noncontrolling interest holder and tax receivable agreement, respectively.

As a result of the reorganization, the Company became a holding company through a series of transactions pursuant to a sale and purchase agreement. Pursuant to the Offering and reorganization, the Company's sole assets are, through its wholly-owned subsidiary HFF Partnership Holdings, LLC, a Delaware limited liability company (HoldCo LLC), partnership interests of HFF LP and HFF Securities and all of the shares of Holliday GP. The transactions that

occurred in connection with the initial public offering and reorganization are referred to as the Reorganization Transactions.

### **Basis of Presentation**

The accompanying consolidated financial statements of the Company as of September 30, 2013 and December 31, 2012 and for the three and nine month periods ended September 30, 2013 and September 30, 2012, include the accounts of HFF LP, HFF Securities, and the Company's wholly-owned subsidiaries, Holliday GP and HoldCo LLC. All significant intercompany accounts and transactions have been eliminated.

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

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As the sole stockholder of Holliday GP (the sole general partner of the Operating Partnerships), the Company now operates and controls all of the business and affairs of the Operating Partnerships. The Company consolidates the financial results of the Operating Partnerships, and the prior ownership interest of HFF Holdings in the Operating Partnerships was treated as a noncontrolling interest in the Company's consolidated financial statements. HFF Holdings, through its wholly-owned subsidiary (Holdings Sub), and the Company, through its wholly-owned subsidiaries (HoldCo LLC and Holliday GP), were the only partners of the Operating Partnerships following the Reorganization Transactions. As of August 31, 2012, HFF Holdings had exchanged all of its remaining interests in the Operating Partnerships and, therefore, the Company, through its wholly-owned subsidiaries, became and continues to be the only equity holder of the Operating Partnerships.

**2. Summary of Significant Accounting Policies**

These interim financial statements have been prepared in accordance with accounting principles generally accepted in the United States ( GAAP ) for interim financial information, the instructions to Quarterly Report on Form 10-Q and Rule 10-01 of Regulation S-X and should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2012. Accordingly, significant accounting policies and disclosures normally provided have been omitted as such items are disclosed therein. In the opinion of management, all adjustments consisting of normal and recurring entries considered necessary for a fair presentation of the results for the interim periods presented have been included. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect reported amounts in the financial statements and accompanying notes. These estimates are based on information available as of the date of the unaudited consolidated financial statements. Therefore, actual results could differ from those estimates. Furthermore, operating results for the three and nine months ended September 30, 2013 are not necessarily indicative of the results expected for the year ending December 31, 2013.

The Company has a firm profit participation plan and office profit participation plans that allow for incentive payments to be made, based on achieving various performance metrics, either in the form of cash or stock at the election of the Company's board of directors. The expense associated with the plans is included within personnel expenses in the consolidated statements of income. The expense recorded for these plans is estimated during the year based on actual results at each interim reporting date and an estimate of future results for the remainder of the year. The plans allow for payments to be made in both cash and share-based awards, the composition of which is determined in the first calendar quarter of the subsequent year. Cash and share-based awards issued under these plans are subject to vesting conditions over the subsequent year, such that the total expense measured for these plans is recorded over the period from the beginning of the performance year through the vesting date. Based on an accounting policy election, the expense associated with the share-based component of the estimated incentive payout is recognized before the grant date of the share-based awards due to the fact that the terms of the incentive compensation plans have been approved by the Company's board of directors and the employees of the Company understand the requirements to earn the award. Prior to the grant date, the share-based component expense is recorded as incentive compensation expense within personnel expenses in the Company's consolidated statements of income. Following the award, if any, of the related incentive payout, the share-based component expense is reclassified as stock compensation costs within personnel expenses and the share-based component of the accrued incentive compensation is reclassified as additional paid-in-capital upon the granting of the awards on the Company's consolidated balance sheets.

**3. Stock Compensation**

The stock compensation cost that has been charged against income for the three and nine months ended September 30, 2013 was \$3.2 million and \$6.4 million, respectively, which is recorded in personnel expenses in the consolidated



statements of income. The stock compensation cost that has been charged against income for the three and nine months ended September 30, 2012 was \$0.9 million and \$2.7 million, respectively. At September 30, 2013, there was approximately \$2.2 million of unrecognized compensation cost related to non-vested restricted stock units with a weighted average remaining contractual term of 0.5 years. As of September 30, 2013, there were 675,080 restricted stock units outstanding, of which 374,673 units are treated as liability awards and require remeasurement of fair value at the end of each reporting period until settlement. Stock compensation expense related to the liability awards that has been included within income for the three and nine months ended September 30, 2013 was \$2.9 million and \$4.9 million, respectively. Stock compensation expense related to the liability awards that has been included within income for the three and nine months ended September 30, 2012 was \$0.5 million and \$1.4 million, respectively.

During the three months ended September 30, 2013, no options were granted, exercised, vested or forfeited.

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During the three month period ending September 30, 2013, no new restricted stock units were granted or vested, and 1,905 restricted stock units were forfeited.

The fair value of vested restricted stock units was \$3.2 million at September 30, 2013.

**4. Property and Equipment**

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

|  | September 30,<br>2013 | December 31,<br>2012 |
|--|-----------------------|----------------------|
| Furniture and equipment                        | \$ 4,983              | \$ 4,583             |
| Computer equipment                             | 808                   | 678                  |
| Capitalized software costs                     | 542                   | 475                  |
| Leasehold improvements                         | 9,345                 | 6,718                |
| Subtotal                                       | 15,678                | 12,454               |
| Less accumulated depreciation and amortization | (8,727)               | (7,654)              |
|  | \$ 6,951              | \$ 4,800             |

At September 30, 2013 and December 31, 2012 the Company has recorded, within furniture and equipment, office equipment under capital leases of \$1.1 million and \$1.1 million, respectively, including accumulated amortization of \$0.6 million and \$0.5 million, respectively, which is included within depreciation and amortization expense in the accompanying consolidated statements of income. See Note 7 for discussion of the related capital lease obligations.

**5. Intangible Assets**

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

|                                  | September 30, 2013          |                             |                      | December 31, 2012           |                             |                      |
|----------------------------------|-----------------------------|-----------------------------|----------------------|-----------------------------|-----------------------------|----------------------|
|                                  | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Net<br>Book<br>Value | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Net<br>Book<br>Value |
| Amortizable intangible assets:   |                             |                             |                      |                             |                             |                      |
| Mortgage servicing rights        | \$ 33,088                   | \$ (16,320)                 | \$ 16,768            | \$ 30,644                   | \$ (12,845)                 | \$ 17,799            |
| Unamortizable intangible assets: |                             |                             |                      |                             |                             |                      |
| FINRA license                    | 100                         |                             | 100                  | 100                         |                             | 100                  |
| Total intangible assets          | \$ 33,188                   | \$ (16,320)                 | \$ 16,868            | \$ 30,744                   | \$ (12,845)                 | \$ 17,899            |

As of September 30, 2013 and December 31, 2012, the Company serviced \$32.2 billion and \$31.3 billion, respectively, of commercial loans. The Company earned \$4.0 million and \$11.8 million in servicing fees and interest

on float and escrow balances for the three and nine month periods ending September 30, 2013, respectively. The Company earned \$3.5 million and \$10.2 million in servicing fees and interest on float and escrow balances for the three and nine month periods ending September 30, 2012, respectively. These revenues are recorded as capital markets services revenues in the consolidated statements of income.

The total commercial loan servicing portfolio includes loans for which there are no corresponding mortgage servicing rights recorded on the balance sheet, as these servicing rights were assumed prior to the Company's adoption of ASC 860, *Transfers and Servicing* (ASC 860) on January 1, 2007 and involved no initial consideration paid by the Company. The Company recorded mortgage servicing rights of \$16.8 million and \$17.8 million on \$26.0 billion and \$24.1 billion, respectively, of the total loans serviced as of September 30, 2013 and December 31, 2012.

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

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Changes in the carrying value of mortgage servicing rights for the nine month periods ended September 30, 2013 and 2012 (dollars in thousands):

| Category             | 12/31/12         | Capitalized     | Amortized         | Sold /            |                  |
|----------------------|------------------|-----------------|-------------------|-------------------|------------------|
|                      |                  |                 |                   | Transferred       | 9/30/13          |
| Freddie Mac          | \$ 7,641         | \$ 2,463        | \$ (1,041)        | \$ (5,133)        | \$ 3,930         |
| CMBS                 | 7,838            | 606             | (1,463)           | 3,948             | 10,929           |
| Life company         | 2,021            | 748             | (1,236)           |                   | 1,533            |
| Life company limited | 299              | 215             | (138)             |                   | 376              |
| <b>Total</b>         | <b>\$ 17,799</b> | <b>\$ 4,032</b> | <b>\$ (3,878)</b> | <b>\$ (1,185)</b> | <b>\$ 16,768</b> |

| Category             | 12/31/11         | Capitalized     | Amortized         | Sold /          |                  |
|----------------------|------------------|-----------------|-------------------|-----------------|------------------|
|                      |                  |                 |                   | Transferred     | 9/30/12          |
| Freddie Mac          | \$ 6,126         | \$ 4,331        | \$ (1,047)        | \$ (2,674)      | \$ 6,736         |
| CMBS                 | 5,273            | 391             | (914)             | 2,162           | 6,912            |
| Life company         | 1,492            | 912             | (714)             |                 | 1,690            |
| Life company limited | 146              | 236             | (88)              |                 | 294              |
| <b>Total</b>         | <b>\$ 13,037</b> | <b>\$ 5,870</b> | <b>\$ (2,763)</b> | <b>\$ (512)</b> | <b>\$ 15,632</b> |

Amounts capitalized represent mortgage servicing rights retained upon the sale of originated loans to Freddie Mac and mortgage servicing rights acquired without the exchange of initial consideration. The Company recorded mortgage servicing rights retained upon the sale of originated loans to Freddie Mac of \$0.6 million and \$2.5 million on \$181.0 million and \$829.9 million of loans, respectively, during the three and nine month periods ending September 30, 2013, respectively, and \$2.1 million and \$4.3 million on \$695.2 million and \$1.5 billion of loans, respectively, during the three and nine month periods ending September 30, 2012, respectively. The Company recorded mortgage servicing rights acquired without the exchange of initial consideration on the CMBS and Life company tranches of \$0.7 million and \$1.6 million on \$1.5 billion and \$3.6 billion of loans, respectively, during the three and nine month periods ending September 30, 2013, respectively, and \$0.5 million and \$1.5 million on \$0.8 billion and \$3.3 billion of loans, respectively, during the three and nine month periods ending September 30, 2012 respectively. During the nine months ending September 30, 2013 and 2012, the Company sold the cashiering portion of certain Freddie Mac mortgage servicing rights. While the Company transferred the risks and rewards of ownership of the cashiering portion of the mortgage servicing rights, the Company continues to perform limited servicing activities on these loans for a reduced market-based fee. Therefore, the remaining servicing rights were transferred to the CMBS servicing tranche. The result of these transactions was the Company recording a gain in the three and nine month periods ending September 30, 2013 of \$1.1 million and \$4.2 million, respectively, and \$0.7 million and \$2.5 million during the three and nine month periods ending September 30, 2012, respectively, within interest and other income, net in the consolidated statements of income. The Company also received securitization compensation in relation to the sale of the cashiering portion of certain Freddie Mac mortgage servicing rights in the three and nine months ending September 30, 2013 of \$0.8 million and \$4.4 million, respectively, and \$0.6 million and \$2.5 million during the three and nine month periods ending September 30, 2012, respectively. The securitization compensation is recorded within interest and other income, net in the consolidated statements of income.

Amortization expense related to intangible assets was \$1.1 million and \$3.9 million during the three and nine month periods ended September 30, 2013 respectively, and \$1.0 million and \$2.8 million during the three and nine month periods ending September 30, 2012, respectively, and is recorded in depreciation and amortization in the consolidated statements of income.

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

|                   |          |
|-------------------|----------|
| Remainder of 2013 | \$ 1,140 |
| 2014              | 4,140    |
| 2015              | 3,305    |
| 2016              | 2,524    |
| 2017              | 1,915    |
| 2018              | 1,398    |

The weighted-average life of the mortgage servicing rights intangible asset was 6.0 years at September 30, 2013.

**Table of Contents****6. Fair Value Measurement**

ASC Topic 820, *Fair Value Measurement* (ASC 820) establishes a valuation hierarchy for disclosure of the inputs to valuation used to measure fair value. This hierarchy prioritizes the inputs into the following three levels: Level 1 inputs which are quoted market prices in active markets for identical assets or liabilities; Level 2 inputs which are observable market-based inputs or unobservable inputs corroborated by market data for the asset or liability; and Level 3 inputs which are unobservable inputs based on the Company's assumptions that are not corroborated by market data. A financial asset or liability's classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

In May 2011, the Financial Accounting Standards Board issued an accounting pronouncement which amends the fair value measurement and disclosure requirements to achieve common disclosure requirements between GAAP and International Financial Reporting Standards. The accounting pronouncement requires certain disclosures about transfers between Level 1 and Level 2 of the fair value hierarchy, sensitivity of fair value measurements categorized within Level 3 of the fair value hierarchy, and categorization by level of items that are reported at cost but are required to be disclosed at fair value. The adoption of this pronouncement had no impact on the Company's consolidated financial statements.

As of September 30, 2013, the Company did not have any assets or liabilities recognized at fair value on a recurring basis.

In accordance with generally accepted accounting principles, from time to time, the Company measures certain assets at fair value on a nonrecurring basis. These assets may include mortgage servicing rights and mortgage notes receivable. The mortgage servicing rights are recorded at fair value upon initial recording and were not re-measured at fair value during the third quarter of 2013 because the Company continues to utilize the amortization method under ASC 860 and the fair value of the mortgage servicing rights exceeds the carrying value at September 30, 2013. The fair value of the mortgage notes receivable was based on prices observable in the market for similar loans. Due to the short term nature of the mortgage note receivable, fair value approximated carrying value at September 30, 2013 and therefore no lower of cost or fair value adjustment was required.

The following table sets forth the Company's financial assets that were accounted for at fair value on a nonrecurring basis by level within the fair value hierarchy as of September 30, 2013 (in thousands):

|   | <b>September 30, 2013</b>             |               |                          |                         |
|---|---------------------------------------|---------------|--------------------------|-------------------------|
|   | <b>Fair Value Measurements Using:</b> |               |                          |                         |
|   | <b>Quoted Prices in</b>               |               |                          |                         |
|   | <b>Active Markets for</b>             |               |                          |                         |
|   | <b>Identical</b>                      |               |                          |                         |
|   | <b>Carrying</b>                       | <b>Assets</b> | <b>Significant Other</b> | <b>Significant</b>      |
|   | <b>Value</b>                          | <b>(Level</b> | <b>Observable</b>        | <b>Unobservable</b>     |
|   |                                       | <b>1)</b>     | <b>Inputs (Level 2)</b>  | <b>Inputs (Level 3)</b> |
| <b>Nonrecurring fair value measurements</b> |                                       |               |                          |                         |
| Mortgage notes receivable                   | \$ 6,660                              | \$            | \$                       | \$ 6,660                |
| Mortgage servicing rights                   | 16,768                                |               |                          | 20,070                  |
| Total nonrecurring fair value measurements  | \$ 23,428                             | \$            | \$                       | \$ 6,660                |
|   |                                       |               |                          | 20,070                  |



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The following table sets forth the Company's financial assets that were accounted for at fair value on a nonrecurring basis by level within the fair value hierarchy as of December 31, 2012 (in thousands):

|   | <b>December 31, 2012</b>              |               |                          |                         |
|---|---------------------------------------|---------------|--------------------------|-------------------------|
|   | <b>Fair Value Measurements Using:</b> |               |                          |                         |
|   | <b>Quoted Prices in</b>               |               |                          |                         |
|   | <b>Active Markets for</b>             |               |                          |                         |
|   | <b>Identical</b>                      |               |                          |                         |
|   | <b>Carrying</b>                       | <b>Assets</b> | <b>Significant Other</b> | <b>Significant</b>      |
|   | <b>Value</b>                          | <b>(Level</b> | <b>Observable Inputs</b> | <b>Unobservable</b>     |
|   |                                       | <b>1)</b>     | <b>(Level 2)</b>         | <b>Inputs (Level 3)</b> |
| <b>Nonrecurring fair value measurements</b> |                                       |               |                          |                         |
| Mortgage notes receivable                   | \$ 261,272                            | \$            | \$ 261,272               | \$                      |
| Mortgage servicing rights                   | 17,799                                |               |                          | 19,848                  |
| Total nonrecurring fair value measurements  | \$ 279,071                            | \$            | 261,272                  | \$ 19,848               |

Mortgage servicing rights do not trade in an active, open market with readily-available observable prices. Since there is no ready market value for the mortgage servicing rights, such as quoted market prices or prices based on sales or purchases of similar assets, the Company determines the fair value of the mortgage servicing rights by estimating the present value of future cash flows associated with the servicing of the loans. Management makes certain assumptions and judgments in estimating the fair value of servicing rights, including the benefits of servicing (contractual servicing fees and interest on escrow and float balances), the cost of servicing, prepayment rates (including risk of default), an inflation rate, the expected life of the cash flows and the discount rate. The significant assumptions utilized to value servicing rights as of September 30, 2013 and December 31, 2012 are as follows:

|                             | <b>September 30, 2013</b> | <b>December 31, 2012</b> |
|-----------------------------|---------------------------|--------------------------|
| Expected life of cash flows | 3 years to 10 years       | 3 years to 10 years      |
| Discount rate (1)           | 15% to 20%                | 15% to 20%               |
| Prepayment rate             | 1% to 8%                  | 0% to 8%                 |
| Inflation rate              | 2%                        | 2%                       |
| Cost of service per loan    | \$ 1,600 to \$3,995       | \$ 1,600 to \$3,989      |

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

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

FASB ASC Topic 825, *Financial Instruments* also requires disclosure of fair value information about financial instruments, whether or not recognized in the accompanying consolidated balance sheets. Our financial instruments,



excluding those included in the preceding fair value tables above, are as follows:

*Cash and Cash Equivalents:* These balances include cash and cash equivalents with maturities of less than three months. The carrying amount approximates fair value due to the short-term maturities of these instruments; these are considered Level 1 fair values.

*Warehouse line of credit:* Due to the short-term nature and variable interest rates of this instrument, fair value approximates carrying value; these are considered Level 2 fair values.

**Table of Contents****7. Capital Lease Obligations**

Capital lease obligations consist of the following at September 30, 2013 and December 31, 2012 (dollars in thousands):

|                           | September 30,<br>2013 | December 31,<br>2012 |
|---------------------------|-----------------------|----------------------|
| Capital lease obligations | \$ 488                | \$ 578               |
| Less current maturities   | 271                   | 299                  |
|                           | \$ 217                | \$ 279               |

Capital lease obligations consist primarily of office equipment leases that expire at various dates through April 2017. A summary of future minimum lease payments under capital leases at September 30, 2013 is as follows (dollars in thousands):

|                   |        |
|-------------------|--------|
| Remainder of 2013 | \$ 78  |
| 2014              | 247    |
| 2015              | 109    |
| 2016              | 47     |
| 2017              | 7      |
|                   | \$ 488 |

**8. Warehouse Line of Credit**

HFF LP maintains two uncommitted warehouse revolving lines of credit for the purpose of funding the Freddie Mac mortgage loans that it originates in connection with its services as a Freddie Mac Multifamily Program Plus<sup>®</sup> Seller/Servicer. The Company is party to an uncommitted \$350 million financing arrangement with PNC Bank, N.A. ( PNC ) and an uncommitted \$125 million financing arrangement with The Huntington Bank ( Huntington ). In May 2013, availability under the Huntington line increased to \$125 million from \$75 million.

Each funding is separately approved on a transaction-by-transaction basis and is collateralized by a loan and mortgage on a multifamily property that is ultimately purchased by Freddie Mac. The PNC and Huntington financing arrangements are only for the purpose of supporting the Company's participation in Freddie Mac's Program Plus Seller/Servicer program and cannot be used for any other purpose. As of September 30, 2013 and December 31, 2012, HFF LP had \$6.7 million and \$261.3 million, respectively, outstanding on the warehouse lines of credit and a corresponding amount of mortgage notes receivable. Interest on the warehouse lines of credit is at the 30-day LIBOR rate (0.18% and 0.21% at September 30, 2013 and December 31, 2012, respectively) plus a spread. HFF LP is also paid interest on its loan secured by a multifamily loan at the rate in the Freddie Mac note.

**9. Lease Commitments**

The Company leases various corporate offices and office equipment under noncancelable operating leases. These leases have initial terms of one to ten years. Several of the leases have termination clauses whereby the term may be reduced by two to seven years upon prior notice and payment of a termination fee by the Company. Total rental expense charged to operations was \$1.9 million and \$5.4 million, respectively, during the three and nine month periods ended September 30, 2013 and \$1.6 million and \$4.7 million, respectively, during the three and nine month periods ending September 30, 2012 and is recorded within occupancy expense in the consolidated statements of income.

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

|                   |           |
|-------------------|-----------|
| Remainder of 2013 | \$ 1,408  |
| 2014              | 5,975     |
| 2015              | 5,942     |
| 2016              | 5,176     |
| 2017              | 4,563     |
| 2018              | 3,650     |
| Thereafter        | 7,631     |
|                   | \$ 34,345 |

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

The Company also leases certain office equipment under capital leases that expire at various dates through 2017. See Note 4 and Note 7 above for further description of the assets and related obligations recorded under these capital leases at September 30, 2013 and December 31, 2012, respectively.

### **10. Servicing**

The Company services commercial real estate loans for investors. The unpaid principal balance of the servicing portfolio totaled \$32.2 billion and \$31.3 billion at September 30, 2013 and December 31, 2012, respectively.

In connection with its servicing activities, the Company holds funds in escrow for the benefit of mortgagors for hazard insurance, real estate taxes and other financing arrangements. At September 30, 2013 and December 31, 2012, the funds held in escrow totaled \$145.1 million and \$172.9 million, respectively. These funds, and the offsetting liabilities of the borrowers to external parties, are not presented in the Company's consolidated financial statements as they do not represent the assets and liabilities of the Company. Pursuant to the requirements of the various investors for which the Company services loans, the Company maintains bank accounts, holding escrow funds, which have balances in excess of the FDIC insurance limit. The fees earned on these escrow funds are reported in capital markets services revenue in the consolidated statements of income.

### **11. Legal Proceedings**

The Company is party to various litigation matters, in most cases involving ordinary course and routine claims incidental to its business. The Company cannot estimate with certainty its ultimate legal