

HFF, Inc.  
Form 10-Q  
May 09, 2008

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

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

**For the quarterly period ended March 31, 2008**

**OR**

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

**For the transition period from to**

**Commission file number: 001-33280**

**HFF, Inc.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State of Incorporation)

**51-0610340**

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

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

(Address of principal executive offices)

**15219**

(Zip code)

(412) 281-8714

(Registrant's telephone number, including area code)

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller Reporting Company

(Do not check if a smaller reporting company)

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

Number of shares of Class A common stock, par value \$0.01 per share, of the registrant outstanding as of May 2, 2008 was 16,445,000 shares.

**HFF, INC. AND SUBSIDIARIES**  
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**March 31, 2008**

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**FORWARD-LOOKING STATEMENTS**

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

**SPECIAL NOTE REGARDING THE REGISTRANT**

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

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

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

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

	<b>March 31, 2008</b>	<b>December 31, 2007</b>
	<i>(unaudited)</i>	<i>(audited)</i>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 36,270	\$ 43,739
Restricted cash (Note 7)	268	370
Accounts receivable	923	1,496
Receivable from affiliate (Note 18)	1,224	1,210
Mortgage notes receivable (Note 8)	36,300	41,000
Prepaid expenses and other current assets	6,160	4,036
Deferred tax asset, net	25	344
Total current assets, net	<b>81,170</b>	92,195
Property and equipment, net (Note 4)	<b>6,341</b>	6,789
Deferred tax asset	<b>125,588</b>	131,408
Goodwill	<b>3,712</b>	3,712
Intangible assets, net (Note 5)	<b>6,158</b>	5,769
Other noncurrent assets	<b>768</b>	603
<b>Total Assets</b>	<b>\$223,737</b>	\$240,476
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Current portion of long-term debt (Note 7)	\$ 82	\$ 78
Warehouse line of credit (Note 8)	<b>36,300</b>	41,000
Accrued compensation and related taxes	<b>5,679</b>	12,952
Accounts payable	<b>1,579</b>	1,946
Current portion of payable to HFF Holdings TRA (Note 13)	<b>5,846</b>	
Other current liabilities	<b>2,843</b>	2,481
Total current liabilities	<b>52,329</b>	58,457
Deferred rent credit	<b>4,347</b>	4,600
Payable to HFF Holdings TRA, less current portion (Note 13)	<b>107,980</b>	117,406
Other long-term liabilities	<b>65</b>	74
Long-term debt, less current portion (Note 7)	<b>104</b>	111
Total liabilities	<b>164,825</b>	180,648
Minority interest (Note 15)	<b>21,686</b>	21,784
Stockholders' equity:		
Class A common stock, par value \$0.01 per share, 175,000,000 authorized, and 16,445,000 shares outstanding	<b>164</b>	164

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Class B common stock, par value \$0.01 per share, 1 share authorized, and 1 share outstanding		
Additional paid-in-capital	<b>25,498</b>	25,353
Retained earnings	<b>11,564</b>	12,527
Total stockholders' equity	<b>37,226</b>	38,044
Total liabilities and stockholders' equity	<b>\$223,737</b>	\$240,476

*See accompanying notes to the consolidated financial statements.*

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

	<b>Three Months Ending March</b>	
	<b>2008</b>	<b>31, 2007</b>
<b>Revenues</b>		
Capital markets services revenue	<b>\$ 31,368</b>	\$ 54,225
Interest on mortgage notes receivable	<b>202</b>	603
Other	<b>610</b>	717
	<b>32,180</b>	55,545
<b>Expenses</b>		
Cost of services	<b>22,310</b>	33,333
Personnel	<b>2,138</b>	4,322
Occupancy	<b>1,855</b>	1,903
Travel and entertainment	<b>1,951</b>	1,506
Supplies, research, and printing	<b>1,911</b>	1,776
Insurance	<b>484</b>	488
Professional fees	<b>904</b>	1,593
Depreciation and amortization	<b>734</b>	1,020
Interest on warehouse line of credit	<b>176</b>	660
Other operating	<b>1,255</b>	1,230
	<b>33,718</b>	47,831
Operating (loss) / income	<b>(1,538)</b>	7,714
Interest and other income	<b>1,006</b>	922
Interest expense	<b>(6)</b>	(394)
(Loss) / income before income taxes and minority interest	<b>(538)</b>	8,242
Income tax expense	<b>523</b>	1,096
(Loss) / income before minority interest	<b>(1,061)</b>	7,146
Minority interest	<b>(98)</b>	3,908
Net (loss) / income	<b>\$ (963)</b>	\$ 3,238
Less net income earned prior to IPO and reorganization <i>(Note 14)</i>		(1,893)
Net (loss) / income attributable to Class A common stockholders	<b>\$ (963)</b>	\$ 1,345
Earnings per share of Class A common stock:		
Basic	<b>\$ (0.06)</b>	\$ 0.13

Diluted

\$ (0.06)

\$ 0.13

*See accompanying notes to the consolidated statements.*

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

	<b>Three Months Ended March 31</b>	
	<b>2008</b>	<b>2007</b>
<b>Operating activities</b>		
Net (loss) / income	\$ (963)	\$ 3,238
Adjustments to reconcile net income to net cash provided by operating activities:		
Minority interest	(98)	3,908
Stock based compensation	168	303
Deferred taxes	2,542	1,209
Depreciation and amortization:		
Property and equipment	418	765
Intangibles	316	255
Gain on sale or disposition of assets	(150)	(284)
Mortgage service rights assumed	(455)	(422)
Increase (decrease) in cash from changes in:		
Restricted cash	102	2,002
Accounts receivable	573	1,750
Receivable from /payable to affiliates	(14)	4,565
Payable to Holdings TRA	(3,580)	
Deferred taxes, net	3,574	
Mortgage notes receivable	4,700	102,500
Prepaid expenses and other current assets	(2,124)	1,751
Other noncurrent assets	(165)	17
Accrued compensation and related taxes	(7,273)	(535)
Accounts payable	(367)	1,034
Other accrued liabilities	362	(588)
Other long-term liabilities	(193)	261
 Net cash (used in) provided by operating activities	 (2,627)	 121,729
<b>Investing activities</b>		
Purchases of property and equipment	(26)	(1,241)
Non-compete agreement	(100)	
 Net cash used in investing activities	 (126)	 (1,241)
<b>Financing activities</b>		
Net borrowings on warehouse line of credit	(4,700)	(102,500)
Payments on long-term debt	(16)	(56,294)
Issuance of common stock, net		272,118
Purchase of ownership interests in Operating Partnerships and Holliday GP		(215,877)
Deferred financing costs		(276)
Members distributions		(3,406)

Net cash used in financing activities	<b>(4,716)</b>	(106,235)
Net (decrease) increase in cash	<b>(7,469)</b>	14,253
Cash and cash equivalents, beginning of period	<b>43,739</b>	3,345
Cash and cash equivalents, end of period	<b>\$36,270</b>	\$ 17,598

*See accompanying notes to the consolidated financial statements.*

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## HFF, Inc.

## Notes to Consolidated Financial Statements

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

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

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

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

**Offering and Reorganization**

HFF, Inc., a Delaware corporation, (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, HFF, Inc. filed a registration statement on Form S-1 with the United States Securities and Exchange Commission (the SEC ) relating to a proposed underwritten initial public offering of 14,300,000 shares of Class A common stock of HFF, Inc. ( the Offering ). On January 30, 2007, the SEC declared the registration statement on Form S-1 effective and 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 public offering were used to purchase from HFF Holdings all of the shares of Holliday GP and purchase from HFF Holdings partnership units representing approximately 39% of each of the Operating Partnerships (including partnership units in the Operating Partnerships held by Holliday GP).

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

In addition to cash received for its sale of all of the shares of Holliday GP and approximately 45% of partnership units of each of the Operating Partnerships (including partnership units in the Operating Partnerships held by Holliday GP), HFF Holdings also received an exchange right that will permit HFF Holdings to exchange interests in the Operating Partnerships for shares of (i) HFF, Inc. s Class A common stock (the Exchange Right ) and (ii) rights under a tax receivable agreement between the Company and HFF Holdings (the TRA ). See Notes 16 and 13 for further discussion of the exchange right held by the majority interest holder and the tax receivable agreement, respectively.

As a result of the reorganization, the Company became a holding company through a series of transactions pursuant to a sale and purchase agreement. Pursuant to the Offering and reorganization, HFF, Inc. s sole assets are through its wholly-owned subsidiary HFF Partnership Holdings, LLC, a Delaware limited liability company ( Partnership Holdings ), partnership interests 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.

The Reorganization Transactions are being treated, for financial reporting purposes, as a reorganization of entities under common control. As such, these financial statements present the consolidated financial position and results of

operations as if HFF, Inc., Holliday GP and the Operating Partnerships (collectively referred to as the Company) were consolidated for all periods presented. All income earned by the Operating Partnerships prior to the offering is attributable to members of HFF Holdings. Income earned by the Operating Partnerships subsequent to the offering and attributable to the members of HFF Holdings is recorded as minority interest in the consolidated financial statements, with remaining income less applicable income taxes attributable to Class A common stockholders.

**Table of Contents****Basis of Presentation**

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

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

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

Income earned by the Operating Partnerships subsequent to the offering and attributable to the members of HFF Holdings based on their remaining ownership interest (see Notes 14 and 15) is recorded as minority interest in the consolidated financial statements, with remaining income less applicable income taxes attributable to Class A common stockholders, and considered in the determination of earnings per share of Class A common stock (see Note 17).

**Reclassifications**

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

**2. Summary of Significant Accounting Policies**

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

**Consolidation**

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

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

**Income Taxes**

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

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

**Earnings Per Share**

Subsequent to the Reorganization Transactions, the Company computes net income per share in accordance with SFAS No. 128, *Earnings Per Share*. Basic net income per share is computed by dividing income available to Class A common stockholders by the weighted average of Class A common shares outstanding for the period. Diluted net income per share reflects the assumed conversion of all dilutive securities (see Note 17). Prior to the Reorganization Transactions, the Company historically operated as a series of related partnerships and limited liability companies. There was no single capital structure upon which to calculate historical earnings per share information. Accordingly, earnings per share information have not been presented for periods prior to the initial public offering.

**Intangible Assets**

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

Servicing rights are capitalized for servicing assumed on loans originated and sold to the Federal Home Loan Mortgage Corporation (Freddie Mac) with servicing retained based on an allocation of the carrying amount of the loan and the servicing right in proportion to the relative fair values at the date of sale. Servicing rights are recorded at the lower of cost or market. Mortgage servicing rights do not trade in an active, open market with readily available observable prices. Since there is no ready market value for the mortgage servicing rights, such as quoted market prices or prices based on sales or purchases of similar assets, the Company determines the fair value of the mortgage servicing rights by estimating the present value of future cash flows associated with servicing the loans. Management makes certain assumptions and judgments in estimating the fair value of servicing rights. The estimate is based on a number of assumptions, including the benefits of servicing (contractual servicing fees and interest on escrow and float balances), the cost of servicing, prepayment rates (including risk of default), an inflation rate, the expected life of the cash flows and the discount rate. The cost of servicing and discount rates are the most sensitive factors affecting the estimated fair value of the servicing rights. Management estimates a market participant's cost of servicing by analyzing the limited market activity and considering the Company's own internal servicing costs. Management estimates the discount rate by considering the various risks involved in the future cash flows of the underlying loans which include the cancellation of servicing contracts, concentration in the life company portfolio and the incremental risk related to large loans. Management estimates the prepayment levels of the underlying mortgages by analyzing recent historical experience. Many of the commercial loans being serviced have financial penalties for prepayment or early payoff before the stated maturity date. As a result, the Company has consistently experienced a low level of loan runoff. The estimated value of the servicing rights is impacted by changes in these assumptions.

Effective January 1, 2007, the Company adopted the provisions of the Statement of Financial Accounting Standards Board (SFAS) No. 156, *Accounting for Servicing of Financial Assets – an amendment of FASB Statement No. 140*, or SFAS 156. Under SFAS 156, the standard requires an entity to recognize a servicing asset or servicing liability at fair value each time it undertakes an obligation to service a financial asset by entering into a servicing contract, regardless of whether explicit consideration is exchanged. The statement also permits a company to choose to either subsequently measure servicing rights at fair value and to report changes in fair value in earnings, or to retain the amortization method whereby servicing rights are recorded at the lower of cost or fair value and are amortized over their expected life. The Company retained the amortization method upon adoption of SFAS 156, but began recognizing the fair value of servicing contracts involving no consideration assumed after January 1, 2007, which resulted in the Company recording \$0.5 million and \$0.4 million of intangible assets and a corresponding amount to income upon initial recognition of the servicing rights for the three month periods ended March 31, 2008 and 2007,

respectively. These amounts are recorded in Interest and other income, net in the Consolidated Income Statement. Deferred financing costs are deferred and are being amortized by the straight-line method over four years, which approximates the effective interest method.

The Company entered into a non-compete agreement for \$0.1 million during the three month period ended March 31, 2008. This non-compete agreement is being amortized by the straight-line method over three years.

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



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

**Stock Based Compensation**

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

**Recent Accounting Pronouncements**

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

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

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

new standard will be required for financial instruments for which fair value is elected.

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

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

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

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

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

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

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

**3. Stock Compensation**

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

The stock compensation cost that has been charged against income for the three months ended March 31, 2008 and 2007 were \$0.2 million and \$0.3 million, respectively, which is recorded in Personnel expenses in the consolidated income statements. At March 31, 2008, there was approximately \$1.9 million of unrecognized compensation cost related to share based awards.

No options were vested or were exercised during the three months ended March 31, 2008.

The fair value of vested RSU's was \$56,000 at March 31, 2008.

The weighted average remaining contractual term of the nonvested restricted stock units is 3 years as of March 31, 2008.

**4. Property and Equipment**

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

	<b>March 31, 2008</b>	<b>December 31, 2007</b>
Furniture and equipment	\$ 3,335	\$ 3,314
Computer equipment	1,147	1,147

Capitalized software costs	<b>735</b>	717
Leasehold improvements	<b>6,038</b>	6,767
Subtotal	<b>11,255</b>	11,945
Less accumulated depreciation and amortization	<b>(4,914)</b>	(5,156)
	<b>\$ 6,341</b>	\$ 6,789

At each of March 31, 2008 and December 31, 2007 the Company has recorded, within furniture and equipment, office equipment under capital leases of \$0.3 million, including accumulated amortization of \$0.1 million, which is included within depreciation and amortization expense on the accompanying consolidated statements of income. See Note 7 for discussion of the related capital lease obligations.

**Table of Contents****5. Intangible Assets**

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

	March 31, 2008			December 31, 2007		
	Gross Carrying Amount	Accumulated Amortization	Net Book Value	Gross Carrying Amount	Accumulated Amortization	Net Book Value
Amortizable intangible assets:						
Mortgage servicing rights	\$ 6,689	\$ (1,012)	\$ 5,677	\$ 6,085	\$ (742)	\$ 5,343
Deferred financing costs	523	(236)	287	523	(197)	326
Non-compete agreement	100	(6)	94			
Unamortizable intangible assets:						
FINRA license	100		100	100		100
Total intangible assets	\$ 7,412	\$ (1,254)	\$ 6,158	\$ 6,708	\$ (939)	\$ 5,769

As of March 31, 2008 and December 31, 2007, the Company serviced \$23.6 billion and \$23.2 billion, respectively, of commercial loans. The Company earned \$2.9 million and \$3.2 million in servicing fees and interest on float and escrow balances for the three month periods ending March 31, 2008 and 2007, respectively. These revenues are recorded as capital markets services revenues in the consolidated statements of income.

The total commercial loan servicing portfolio includes loans for which there is no corresponding mortgage servicing right recorded on the balance sheet, as these servicing rights were assumed prior to January 1, 2007 and involved no initial consideration paid by the Company. The Company has recorded mortgage servicing rights of \$5.7 million and \$5.3 million on \$8.7 billion and \$7.9 billion, respectively, of the total loans serviced as of March 31, 2008 and December 31, 2007.

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

Mortgage servicing rights do not trade in an active, open market with readily available observable prices. Since there is no ready market value for the mortgage servicing rights, such as quoted market prices or prices based on sales or purchases of similar assets, the Company determines the fair value of the mortgage servicing rights by estimating the present value of future cash flows associated with the servicing the loans. Management makes certain assumptions and judgments in estimating the fair value of servicing rights. The estimate is based on a number of assumptions, including the benefits of servicing (contractual servicing fees and interest on escrow and float balances), the cost of servicing, prepayment rates (including risk of default), an inflation rate, the expected life of the cash flows and the discount rate. The significant assumptions utilized to value servicing rights as of March 31, 2008 are as follows:

Expected life of cash flows: 3 years to 10 years

Discount rate(1): 15% 20%

Prepayment rate: 0% 7%

Inflation rate: 2%

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

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

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

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Changes in the carrying value of mortgage servicing rights for the three months period ending March 31, 2008 and 2007, and the fair value at the end of each period were as follows:

<b>Category</b>	<b>12/31/07</b>	<b>Capitalized</b>	<b>Amortized</b>	<b>Impairment</b>	<b>3/31/08</b>	<b>FV at 3/31/08</b>
Freddie Mac	\$ 2,183	\$ 150	\$ (84)	\$	\$ 2,249	\$ 2,801
CMBS	2,414	265	(93)		2,586	2,762
Life company limited	112	27	(17)		122	238
Life company	634	163	(77)		720	1,051
<b>Total</b>	<b>\$ 5,343</b>	<b>\$ 605</b>	<b>\$ (271)</b>	<b>\$</b>	<b>\$ 5,677</b>	<b>\$ 6,852</b>

<b>Category</b>	<b>12/31/06</b>	<b>Capitalized</b>	<b>Amortized</b>	<b>Impairment</b>	<b>3/31/07</b>	<b>FV at 3/31/07</b>
Freddie Mac	\$ 600	\$ 284	\$ (20)	\$	\$ 864	\$ 926
CMBS		189			189	189
Life company limited						
Life company	1,790	233	(189)		1,834	2,211
<b>Total</b>	<b>\$ 2,390</b>	<b>\$ 706</b>	<b>\$ (209)</b>	<b>\$</b>	<b>\$ 2,887</b>	<b>\$ 3,326</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 \$0.1 million and \$0.3 million on \$73.2 million and \$187.1 million of loans, respectively, during the three month period ending March 31, 2008 and 2007, respectively. The Company recorded mortgage servicing rights acquired without the exchange of initial consideration of \$0.5 million and \$0.4 million on \$734.1 million and \$1.1 billion of loans, respectively, during the three month period ending March 31, 2008 and 2007, respectively. These amounts are recorded in Interest and Other Income, net in the consolidated statements of income.

Amortization expense related to intangible assets was \$0.3 million for each of the three month periods ended March 31, 2008 and 2007 and is recorded in Depreciation and Amortization in the consolidated statements of income. See Note 2 for further discussion regarding treatment of servicing rights prior to January 1, 2007.

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

Remainder of 2008	\$ 945
2009	1,180
2010	861
2011	614
2012	573
2013	539

The weighted-average life of the mortgage servicing rights intangible asset was eight years at March 31, 2008. The remaining lives of the deferred financing costs and non-compete agreement intangible assets were two and three years, respectively, at March 31, 2008.

**6. Fair Value Measurement**

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

As of March 31, 2008, 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 were not measured at fair value during the first quarter of 2008 as the Company continues to utilize the amortization method under SFAS 156 and the fair value of the mortgage servicing rights exceeds the carrying value at March 31, 2008. See Note 5 for further discussion on the assumptions used in valuing the mortgage servicing rights and impact on earnings during the period. The fair value of the mortgage notes receivable was based on prices observable in the market for similar loans and equaled carrying value at March 31, 2008. Therefore, no lower of cost or fair value adjustment was required.



**Table of Contents****7. Long-Term Debt and Capital Lease Obligations**

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

	<b>March 31, 2008</b>	<b>December 31, 2007</b>
Bank term note payable	\$	\$
Capital lease obligations	186	189
Total long-term debt and capital leases	186	189
Less current maturities	82	78
Long-term debt and capital leases	\$ 104	\$ 111

**(a) The Credit Agreement**

On February 5, 2007, the Company entered into an Amended and Restated Credit Agreement with Bank of America ( Amended Credit Agreement ). The Amended Credit Agreement is comprised of a \$40.0 million revolving credit facility, which replaced the old Credit Agreement that was paid off in connection with the initial public offering. The Amended Credit Agreement matures on February 5, 2010 and may be extended for one year based on certain conditions as defined in the agreement. Interest on outstanding balances is payable at the applicable LIBOR rate (for interest periods of one, two, three, six or twelve months) plus 200 basis points, 175 basis points or 150 basis points (such rate is determined from time to time in accordance with the Amended Credit Agreement, based on our then applicable consolidated leverage ratio) or at interest equal to the higher of (a) the Federal Funds Rate (2.51% at March 31, 2008) plus 0.5% and (b) the Prime Rate (5.25% at March 31, 2008) plus 1.5%. The Amended Credit Agreement also requires payment of a commitment fee of 0.2% or 0.3% on the unused amount of credit based on the total amount outstanding. The Company did not borrow on this revolving credit facility during the period February 5, 2007 through March 31, 2008. On October 30, 2007, the Company entered into an amendment to the Amended Credit Agreement to clarify that the \$40.0 million line of credit under the Amended Credit Agreement is available to the Company for purposes of originating such Freddie Mac loans (see discussion under Note 8 below).

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

At March 31, 2008 and December 31, 2007, the Company has outstanding letters of credit of approximately \$0.2 million with the same bank as the term note and revolving credit arrangements, to comply with bonding requirements of certain state regulatory agencies and as security for two leases. The Company segregated cash in a separate bank account to collateralize the letters of credit. The letters of credit expire through 2008 but can be automatically extended for one year.

Capital lease obligations consist primarily of office equipment leases that expire at various dates through December 2010 and bear interest at rates ranging from 3.65% to 9.00%. A summary of future minimum lease payments under capital leases at March 31, 2008, is as follows (in thousands):

Remainder of 2008	\$	61
2009		79
2010		46
	\$	186

**8. Warehouse Line of Credit**

In 2005, HFF LP obtained an uncommitted warehouse line of credit of \$150.0 million for the purpose of funding the Freddie Mac mortgage loans that it originates. In November 2007, the Company entered into a \$50.0 million line of

credit note with an additional warehouse lender to serve as a supplement to the existing warehouse line of credit. The Company also is permitted to use borrowings under the Amended Credit Agreement to originate and subsequently sell mortgages in connection with the Company's participation in Freddie Mac's Multifamily Program PfuSeller/Service program. Each funding is separately approved on a transaction-by-transaction basis and is collateralized by a loan and mortgage on a multifamily property that is ultimately purchased by Freddie Mac. As of March 31, 2008 and December 31, 2007, HFF LP had \$36.3 million and \$41.0 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 (2.81% and 5.02% at March 31, 2008 and December 31, 2007, respectively) plus a spread. HFF LP is also paid interest on its loan secured by a multifamily loan at the rate in the Freddie Mac note.

**9. Lease Commitments**

The Company leases various corporate offices, parking spaces, and office equipment under noncancelable operating leases. These leases have initial terms of two to ten years. The majority of the leases have termination clauses whereby the term may be reduced by two to seven years upon prior notice and payment of a termination fee by the Company. Total rental expense charged to operations was \$1.4 million for each of the three months ended March 31, 2008 and 2007.

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

Remainder of 2008	\$ 3,645
2009	4,130
2010	3,755
2011	3,223
2012	3,032
2013	1,946
Thereafter	3,688
	\$ 23,419

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

The Company also leases certain office equipment under capital leases that expire at various dates through 2010. See Note 4 and Note 7 above for further description of the assets and related obligations recorded under these capital leases at March 31, 2008 and December 31, 2007, respectively.

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

**10. Servicing**

The Company services commercial real estate loans for investors. The servicing portfolio totaled \$23.6 billion and \$23.2 billion at March 31, 2008 and December 31, 2007, respectively.

In connection with its servicing activities, the Company holds funds in escrow for the benefit of mortgagors for hazard insurance, real estate taxes and other financing arrangements. At March 31, 2008 and December 31, 2007, the funds held in escrow totaled \$95.7 million and \$99.8 million, respectively. These funds, and the offsetting liabilities, are not presented in the Company's consolidated financial statements as they do not represent the assets and liabilities of the Company. Pursuant to the requirements of the various investors for which the Company services loans, the Company maintains bank accounts, holding escrow funds, which have balances in excess of the FDIC insurance limit. The fees earned on these escrow funds are reported in capital markets services revenue in the consolidated statements of income.

**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 and financial liability with respect to any pending matters. In accordance with SFAS 5, *Accounting for Contingencies*, a reserve for estimated losses is recorded when the amount is probable and can be reasonably estimated. However, the Company believes, based on examination of such pending matters that its ultimate liability will not have a material adverse effect on its business or financial condition.

**12. Income Taxes**

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

	<b>Current</b>	<b>Deferred</b>	<b>Total</b>
Quarter Ended March 31, 2008:			
Federal	\$ (1,769)	\$ 2,234	\$ 465
State	(250)	308	58
	\$ (2,019)	\$ 2,542	\$ 523

	<b>Current</b>	<b>Deferred</b>	<b>Total</b>
Quarter Ended March 31, 2007:			
Federal	\$	\$ 902	\$ 902
State	60	134	194
	\$ 60	\$ 1,036	\$ 1,096

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The reconciliation between the income tax computed by applying the U.S. federal statutory rate and the effective tax rate on net income is as follows for the three months ended March 31, 2008 and 2007 (dollars in thousands):

	March 31, 2008	March 31, 2007
Pre-tax book (loss) / income	\$ (538)	\$ 8,242
Less: income earned prior to IPO and Reorganization Transactions		1,893
Less: (loss) / income allocated to minority interest holder	(33)	3,943
Pre-tax book (loss) / income after minority interest	\$ (505)	\$ 2,406

**Income Tax expense**

		<b>Rate</b>
Taxes computed at federal rate	\$ (172)	34.0%
State and local taxes, net of federal tax benefit	94	(18.6%)
Effect of deferred tax rate change	608	(120.4%)
Meals and entertainment	(17)	3.4%
Other	10	(2.0%)
Income tax expense	\$ 523	(103.6%)

Total income tax expense recorded for the three months ended March 31, 2008 and 2007, included \$65,400 and \$35,000 of state and local taxes on income allocated to the minority interest holder, which represents 14.9% and 0.3% of the total effective rate, respectively.

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

	March 31, 2008	December 31, 2007
Deferred income tax assets		
Section 754 election tax basis step-up	\$ 143,831	\$ 150,007
Tenant improvements	474	405
Goodwill	8	27
Restricted stock units	237	204
Compensation		293
Other	81	34
	144,631	150,970
Less: valuation allowance	(17,733)	(18,177)
Deferred income tax asset	126,898	132,793
Deferred income tax liabilities		
Compensation	(68)	
Servicing rights	(937)	(830)
Deferred rent	(280)	(211)

Deferred income tax liability	(1,285)	(1,041)
Net deferred income tax asset (liability)	\$ 125,613	\$ 131,752

In evaluating the realizability of the deferred tax assets, management makes estimates and judgments regarding the level and timing of future taxable income, including reviewing forward-looking analyses. Based on this analysis and other quantitative and qualitative factors, management believes that it is more likely than not that the Company will be able to generate sufficient taxable income to realize a portion of the deferred tax assets resulting from the initial basis step up recognized from the Reorganization Transaction. Deferred tax assets representing the tax benefits to be realized when future payments are made to HFF Holdings under a tax receivable agreement are currently not more likely than not to be realized and, therefore, have a valuation allowance of \$17.7 million recorded against them. See Note 13 for further information regarding the Company's tax receivable agreement with HFF Holdings. The effects of changes in this initial valuation allowance will be recorded in equity if management's future analysis determines that it is more likely than not that these benefits will be realized. All other effects of changes in the Company's estimates regarding the realization of the deferred tax assets will be included in net income. Similarly, the effect of subsequent changes in the enacted tax rates will be included in net income.

In June 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement 109, or FIN 48. FIN 48 prescribes recognition and measurement standards for a tax position taken or expected to be taken in a tax return. The evaluation of a tax position in accordance with FIN 48 is a two-step process. The first step is the determination of whether a tax position should be recognized. Under FIN 48, a tax position taken or expected to be taken in a tax return is to be recognized only if the Company determines that it is more-likely-than-not that the tax position will be sustained upon examination by the tax authorities based upon the technical merits of the position. In step two, for those tax positions which should be recognized, the measurement of a tax position is determined as being the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement. The Company adopted FIN 48 on January 1, 2007, the effect of which was immaterial to the consolidated financial statements. The Company has determined that no unrecognized tax benefits need to be recorded as of March 31, 2008.

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The Company will recognize interest and penalties related to unrecognized tax benefits in Interest and other income. There were no interest or penalties recorded in the three month periods ending March 31, 2008 and 2007.

**13. Tax Receivable Agreement**

In connection with the Reorganization Transactions, HFF LP and HFF Securities made an election under Section 754 of the Internal Revenue Code for 2007, and intend to keep that election in effect for each taxable year in which an exchange of partnership units for shares occurs. The initial sale as a result of the offering increased the tax basis of the assets owned by HFF LP and HFF Securities to their fair market value. This increase in tax basis allows the Company to reduce the amount of future tax payments to the extent that the Company has future taxable income. As a result of the increase in tax basis, the Company is entitled to future tax benefits of \$133.9 million and has recorded this amount as a deferred tax asset on its Consolidated Balance Sheet. The Company has updated its estimate of these future tax benefits based on the changes to the estimated annual effective tax rate for 2007. The Company is obligated, however, pursuant to its tax receivable agreement with HFF Holdings, to pay to HFF Holdings, 85% of the amount of cash savings, if any, in U.S. federal, state and local income tax that the Company actually realizes as a result of these increases in tax basis and as a result of certain other tax benefits arising from the Company entering into the tax receivable agreement and making payments under that agreement. For purposes of the tax receivable agreement, actual cash savings in income tax will be computed by comparing the Company's actual income tax liability to the amount of such taxes that it would have been required to pay had there been no increase to the tax basis of the assets of HFF LP and HFF Securities as a result of the initial sale and later exchanges had the Company not entered into the tax receivable agreement.

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

While the actual amount and timing of payments under the tax receivable agreement will depend upon a number of factors, including the amount and timing of taxable income generated in the future, changes in future tax rates, the value of individual assets, the portion of the Company's payments under the tax receivable agreement constituting imputed interest and increases in the tax basis of the Company's assets resulting in payments to HFF Holdings, the Company has estimated that the payments that will be made to HFF Holdings will be \$113.8 million and has recorded this obligation to HFF Holdings as a liability on the Consolidated Balance Sheets. The Company has recorded the difference of \$20.1 million between the \$133.9 million tax benefit due to the basis increase and the \$113.8 million liability to HFF Holdings as a \$20.7 million increase in Stockholders' Equity as of December 31, 2007 and \$0.6 million as a tax expense during the three-month period ended March 31, 2008. The term of the tax receivable agreement commenced upon consummation of the offering (January 31, 2007) and will continue until all such tax benefits have been utilized or expired, including the tax benefits derived from future exchanges.

**14. Supplemental Statements of Income**

The Supplemental Statements of Income set forth in the table below are provided to principally give additional information regarding the Company's change in ownership interests in the Operating Partnerships that occurred during the three month periods ending March 31, 2007. The changes in the Company's ownership interest in the Operating Partnerships are a result of the initial public offering on January 30, 2007, and the underwriters' exercise of their option to purchase additional shares on February 21, 2007.

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

	<b>Period 1/1/07 through 1/30/07</b>	<b>Period 1/31/07 through 2/21/07</b>	<b>Period 2/22/07 through 3/31/07</b>	<b>Three Months Ended March 31, 2007</b>
Revenue	\$ 17,467	\$ 12,308	\$ 25,770	\$ 55,545
Operating expenses:				
Cost of services	10,817	7,960	14,556	33,333
Operating, administrative and other	4,427	2,863	6,188	13,478
Depreciation and amortization	358	273	389	1,020
Total Expenses	15,602	11,096	21,133	47,831
Operating income	1,865	1,212	4,637	7,714
Interest and other income	401	169	352	922
Interest expense	(373)	(14)	(7)	(394)
Income before income taxes and minority interest	1,893	1,367	4,982	8,242
Income tax expense		151	945	1,096
Income before minority interest	1,893	1,216	4,037	7,146
Minority interest		1,029	2,879	3,908
Net income	\$ 1,893	\$ 187	\$ 1,158	\$ 3,238
Less net income earned prior to IPO and reorg.		(1,893)		(1,893)
Income available to common stockholders	\$	\$ 187	\$ 1,158	\$ 1,345
Net income per share basic				0.13
Net income per share diluted				0.13

**15. Minority Interest**

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



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	Period 1/1/07 through 1/30/07	Period 1/31/07 through 2/21/07	Period 2/22/07 through 3/31/07	Three months ended 3/31/07	Three months ended 3/31/08
Net income/(loss) from operating partnerships	\$ 1,922	\$ 1,683	\$ 5,206	\$ 8,811	\$ (177)
Minority interest ownership percentage		61.14%	55.31%		55.31%
Minority interest		\$ 1,029	\$ 2,879	\$ 3,908	\$ (98)

**16. Stockholders Equity**

The Company is authorized to issue 175,000,000 shares of Class A common stock, par value \$0.01 per share, and 1 share of Class B common stock, par value \$0.01 per share. Each share of Class A common stock entitles its holder to one vote on all matters to be voted on by stockholders generally. HFF Holdings has been issued one share of Class B common stock. Class B common stock has no economic rights but entitles the holder to a number of votes equal to the total number of shares of Class A common stock for which

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the partnership units that HFF Holdings holds in the Operating Partnerships, as of the relevant record date for the HFF, Inc. stockholder action, are exchangeable. Holders of Class A and Class B common stock will vote together as a single class on all matters presented to our stockholders for their vote or approval. The Company has issued 16,445,000 shares of Class A common stock and 1 share of Class B common stock as of March 31, 2008 and December 31, 2007, respectively.

**17. Earnings Per Share**

The Company's net income and weighted average shares outstanding for the three month periods ended March 31, 2008 and 2007, consist of the following (*dollars in thousands*):

	<b>Three months ended 3/31/08</b>	<b>Three months ended 3/31/07</b>
Net (loss) / income	\$ (963)	\$ 3,238
Net (loss) / income available for Class A common stockholders	\$ (963)	\$ 1,345
Weighted Average Shares Outstanding:		
Basic	16,456,110	10,422,574
Diluted	16,456,110	10,427,320

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

**Basic Net Income per Share**

*Numerator* net (loss) / income attributable to Class A common stockholders for the three month period ended March 31, 2008 and 2007, respectively.

*Denominator* the weighted average shares of Class A common stock for the three month period ended March 31, 2008 and 2007, including 11,110 restricted stock units that have vested and whose issuance is no longer contingent.

**Diluted Net Income per Share**

*Numerator* net (loss) / income attributable to Class A common stockholders for the three month period ended March 31, 2008 and 2007 as in the basic net (loss) / income per share calculation described above plus income allocated to minority interest holder upon assumed exercise of exchange rights.

*Denominator* the weighted average shares of Class A common stock for the three month period ended March 31, 2008 and 2007, including 11,110 restricted stock units that have vested and whose issuance is no longer contingent, plus the dilutive effect of the unrestricted stock units, stock options, and the issuance of Class A common stock upon exercise of the exchange right by HFF Holdings.

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	<b>Three Months Ended March 31, 2008</b>	<b>Three Months Ended March 31, 2007</b>
<b>Basic Earnings Per Share of Class A Common Stock</b>		
Numerator:		
Net (loss) / income attributable to Class A common stockholders	\$ (963)	\$ 1,345
Denominator:		
Weighted average number of shares of Class A common stock outstanding	16,456,110	10,422,574
Basic net (loss) / income per share of Class A common stock	\$ (0.06)	\$ 0.13
<b>Diluted Earnings Per Share of Class A Common Stock</b>		
Numerator:		
Net (loss) / income attributable to Class A common stockholders	\$ (963)	\$ 1,345
Add dilutive effect of:		
Income allocated to minority interest holder upon assumed exercise of exchange right		
Denominator:		
Basic weighted average number of shares of Class A common stock	16,456,110	10,422,574
Add dilutive effect of:		
Unvested restricted stock units		4,746
Stock options		
Minority interest holder exchange right		
Weighted average common shares outstanding diluted	16,456,110	10,427,320
Diluted earnings per share of Class A common stock	\$ (0.06)	\$ 0.13

**18. Related Party Transactions**

The Company made payments on behalf of two affiliates of \$156 and \$13,215 respectively, during the three month period ended March 31, 2008. The Company had a net receivable from affiliates at March 31, 2008 and December 31, 2007 of \$1.2 million.

The Company allocated expenses for two affiliates for services performed on behalf of the affiliates of approximately \$56,000 during the three months ended March 31, 2007. The Company made payments on behalf of and allocated additional expenses to two affiliates of approximately \$0.9 million and \$0.1 million, respectively, during the three months ended March 31, 2007. The Company received amounts from two affiliates of approximately \$1.5 million during the three months ended March 31, 2007. In addition, the Company recorded a payable to two affiliates in the amount of \$3.5 million during the three months ended March 31, 2007 for net working capital adjustments as a result of the IPO transaction. The Company had a net payable to affiliates at March 31, 2007 of \$1.0 million and had a net receivable from affiliates of \$3.0 million at December 31, 2007.

As a result of the Company's initial public offering, the Company entered into a tax receivable agreement with HFF Holdings that provides for the payment by the Company to HFF Holdings of 85% of the amount of the cash savings, if any, in U.S. federal, state and local income tax that the Company actually realizes as a result of the increase in tax basis of the assets owned by HFF LP and HFF Securities and as a result of certain other tax benefits arising from our entering into the tax receivable agreement and making payments under that agreement. The Company will retain the remaining 15% of cash savings, if any, in income tax that it realizes. For purposes of the tax receivable agreement, cash savings in income tax will be computed by comparing the Company's actual income tax liability to the amount of such taxes that it would have been required to pay had there been no increase to the tax basis of the assets of HFF LP and HFF Securities allocable to the Company as a result of the initial sale and later exchanges and had the Company not entered into the tax receivable agreement. The term of the tax receivable agreement commenced upon

consummation of the offering and will continue until all such tax benefits have been utilized or have expired. See Note 13 for further information regarding the tax receivable agreement and Note 19 for the amount recorded in relation to this agreement.

**19. Commitments and Contingencies**

The Company is obligated pursuant to its tax receivable agreement with HFF Holdings, to pay to HFF Holdings, on an after tax basis, 85% of the amount of tax the Company saves for each tax period as a result of the increased tax benefits. The Company has recorded \$113.8 million for this obligation to HFF Holdings as a liability on the consolidated balance sheet.

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

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

**Overview***Our Business*

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

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

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

Our business may be significantly affected by factors outside of our control, particularly including:

*Economic and commercial real estate market downturns.* Our business is dependent on international and domestic economic conditions and the demand for commercial real estate and related services in the markets in which we operate and even a regional economic downturn could adversely affect our business. A general decline in acquisition and disposition activity can lead to a reduction in fees and commissions for arranging such transactions, as well as in fees and commissions for arranging financing for acquirers and property owners that are seeking to recapitalize their existing properties. Likewise, a general decline in commercial real estate investment activity can lead to a reduction in fees and commissions for arranging acquisitions, dispositions and financings for acquisitions as well as for recapitalizations for existing property owners as well as a significant reduction in our loan servicing activities, due to increased delinquencies and defaults and lack of additional loans that we would have otherwise added to our loan servicing portfolio, all of which would have an adverse effect on our business.

*Decreased investment allocation to commercial real estate class.* Allocations to commercial real estate as an asset class for investment portfolio diversification may decrease for a number of reasons beyond our control, including but not limited to poor performance of the asset class relative to other asset classes or superior performance of other asset classes when compared with continued good performance of the commercial real estate asset class. In addition, while commercial real estate is now viewed as an accepted and valid class for portfolio diversification, if this perception changes, there could be a significant reduction in the amount of debt and equity capital available in the commercial real estate sector.

*Global and domestic credit and liquidity issues.* Global and domestic credit and liquidity issues could lead to a decrease in transaction activity and lower values. Restrictions on the availability of capital, both debt and/or equity, can create significant reductions in the liquidity in and flow of capital to the commercial real estate markets. These restrictions could also cause commercial real estate prices to decrease due to the reduced amount of equity capital and debt financing available. In particular, global and domestic credit and liquidity issues may reduce the number of acquisitions, dispositions and loan originations, as well as the respective number of transactions and transaction volumes, which could also adversely affect our capital markets services revenues including our servicing revenue.

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

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

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

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

**Results of Operations**

Following is a discussion of our results of operations for the three months ended March 31, 2008 and March 31, 2007. The table included in the period comparisons below provides summaries of our results of operations. The period-to-period comparisons of financial results are not necessarily indicative of future results.

	For the Three Months Ended		March 31,		Total Dollar Change	Total Percentage Change
	2008		2007			
	Dollars	% of Revenue	Dollars	% of Revenue		
(dollars in thousands, unless percentages)						
Revenues						
Capital markets services revenue	\$31,368	97.5%	\$54,225	97.6%	\$(22,857)	(42.2)%
Interest on mortgage notes receivable	202	0.6%	603	1.1%	(401)	(66.5)%
Other	610	1.9%	717	1.3%	(107)	(14.9)%
<b>Total revenues</b>	<b>32,180</b>	<b>100.0%</b>	<b>55,545</b>	<b>100.0%</b>	<b>(23,365)</b>	<b>(42.1)%</b>
Operating expenses						
Cost of services	22,310	69.3%	33,333	60.0%	(11,023)	(33.1)%
Personnel	2,138	6.6%	4,322	7.8%	(2,184)	(50.5)%
Occupancy	1,855	5.8%	1,903	3.4%	(48)	(2.5)%
Travel and entertainment	1,951	6.1%	1,506	2.7%	445	29.5%
Supplies, research and printing	1,911	5.9%	1,776	3.2%	135	7.6%
Other	3,553	11.0%	4,991	9.0%	(1,438)	(28.8)%
<b>Total operating expenses</b>	<b>33,718</b>	<b>104.8%</b>	<b>47,831</b>	<b>86.1%</b>	<b>(14,113)</b>	<b>(29.5)%</b>
Operating (loss) / income	(1,538)	(4.8)%	7,714	13.9%	(9,252)	(119.9)%
Interest and other income	1,006	3.1%	922	1.7%	84	9.1%
Interest expense	(6)	(0.0)%	(394)	(0.7)%	388	(98.5)%
(Loss) / income before income taxes and minority interest	(538)	(1.7)%	8,242	14.8%	(8,780)	(106.5)%
Income tax expense	523	1.6%	1,096	2.0%	(573)	(52.3)%
(Loss) income before minority interest	(1,061)	(3.3)%	7,146	12.9%	(8,207)	(114.8)%
Minority interest	(98)	(0.3)%	3,908	7.0%	(4,006)	(102.5)%
<b>Net (loss) / income</b>	<b>\$ (963)</b>	<b>(3.0)%</b>	<b>\$ 3,238</b>	<b>5.8%</b>	<b>\$ (4,201)</b>	<b>(129.7)%</b>

*Revenues.* Our total revenues were \$32.2 million for the three months ended March 31, 2008 compared to \$55.5 million for the same period in 2007, a decrease of \$23.4 million, or 42.1%. Revenues decreased primarily as a result of the decrease in production volumes in several of our capital markets services platforms.

The revenues we generated from capital markets services for the three months ended March 31, 2008 decreased \$22.9 million, or 42.2%, to \$31.4 million from \$54.2 million for the same period in 2007. The decrease is primarily attributable to a decrease in both the number and the average dollar value of transactions closed during the first quarter of 2008 compared to the first quarter of 2007.

The revenues derived from interest on mortgage notes were \$0.2 million for the three months ended March 31, 2008 compared to \$0.6 million for the same period in 2007, a decrease of \$0.4 million. Revenues decreased primarily as a result of decreased volume of Freddie Mac loans in the first quarter of 2008 compared to the first quarter of 2007.

The other revenues we earned were approximately \$0.6 million for the three month period ended March 31, 2008 and \$0.7 million for the three month period ending March 31, 2007.

*Total Operating Expenses.* Our total operating expenses were \$33.7 million for the three months ended March 31, 2008 compared to \$47.8 million for the same period in 2007, a decrease of \$14.1 million, or 29.5%. Expenses decreased primarily due to decreased cost of services due to a decrease in capital markets services revenue, decreased personnel costs due to a decrease in revenue and decreased professional fees, interest on our warehouse line of credit and depreciation and amortization.



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The costs of services for the three months ended March 31, 2008 decreased \$11.0 million, or 33.1%, to \$22.3 million from \$33.3 million for the same period in 2007. The decrease is primarily the result of the decrease in commissions and other incentive compensation directly related to the decrease in capital markets services revenues. Cost of services as a percentage of capital markets services and other revenues were approximately 69.8% and 60.7% for the three month periods ended March 31, 2008 and March 31, 2007, respectively. This percentage increase is primarily attributable to a \$0.3 million increase in salary expense in the quarter ended March 31, 2008, compared to the same period in the prior year.

Personnel expenses that are not directly attributable to providing services to our clients for the three months ended March 31, 2008 decreased \$2.2 million, or 50.5%, to \$2.1 million from \$4.3 million for the same period in 2007. The decrease is primarily related to a decrease in profit participation expense resulting from the lower operating income during the three months ended March 31, 2008.

Occupancy, travel and entertainment, and supplies, research and printing expenses for the three months ended March 31, 2008 increased \$0.5 million, or 10.3%, to \$5.7 million compared to the same period in 2007. These increases are primarily due to increased travel and entertainment activity primarily related to the generation of existing business and the solicitation of new business activity.

Other expenses, including costs for insurance, professional fees, depreciation and amortization, interest on our warehouse line of credit and other operating expenses, were \$3.6 million in the three months ended March 31, 2008, a decrease of \$1.4 million, or 28.8%, versus \$5.0 million in the three months ended March 31, 2007. This decrease is primarily related to decreased interest expense of \$0.5 million on the warehouse line of credit due to a lower balance outstanding at March 31, 2008 compared to March 31, 2007 and a decrease in professional fees in the amount of \$0.7 million. The Company experienced higher professional fees during the three month period ended March 31, 2007 primarily as a consequence of fees related to the Company's initial public offering that were incurred during this period.

*Net (Loss) / Income.* Our net (loss) / income for the three months ended March 31, 2008 was \$(1.0) million, a decrease of \$4.2 million versus income of \$3.2 million for the same fiscal period in 2007. We attribute this decrease to several factors, with the most significant cause being a decrease of revenues of \$23.4 million. Other factors slightly offsetting this decrease included:

The interest expense we incurred in the three months ended March 31, 2008 totaled \$6,000, a decrease of \$0.4 million from \$0.4 million of similar expenses incurred in the three months ended March 31, 2007. This decrease resulted from interest expense in the amount of \$0.4 million on a Credit Agreement with Bank of America in the three months ended March 31, 2007. The outstanding balance of \$56.3 million under this Credit Agreement was paid off with the proceeds from the initial public offering and we contemporaneously entered into an Amended Credit Agreement with Bank of America providing for our current \$40.0 million line of credit.

Income tax expense was approximately \$0.5 million for the three months ended March 31, 2008, a decrease of \$0.6 million from \$1.1 million in the three months ended March 31, 2007. This decrease is primarily due to the net operating loss experienced during the three months ended March 31, 2008 compared net operating income generated in the three months ended March 31, 2007. During the three months ended March 31, 2008, the Company recorded a current income tax benefit of \$2.0 million. This current tax benefit was offset by deferred income tax expense of \$2.5 million, primarily relating to the amortization of the step-up in basis from the Section 754 election.

**Financial Condition**

Total assets decreased to \$223.7 million at March 31, 2008, from \$240.5 million at December 31, 2007, primarily due to:

A decrease in cash and cash equivalents of \$7.5 million resulting from the payment of year end profit participation and other bonus accruals.

A decrease in mortgage notes receivable due to lower balance loans pending sale to Freddie Mac at March 31, 2008, compared to December 31, 2007.

A decrease in the deferred tax asset primarily as a result of the amortization of the step-up in basis from the section 754 election..

These decreases were partially offset by a \$2.1 million increase in prepaid and other assets, primarily the result of the recording of a current income tax benefit of \$2.0 million during the three months ending March 31, 2008.

Total liabilities decreased \$15.8 million at March 31, 2008, from \$180.6 million at December 31, 2007, primarily due to:

A reduction in the warehouse line of credit due to lower balance loans pending sale to Freddie Mac at March 31, 2008, compared to December 31, 2007.

A decrease in Accrued Compensation and related taxes due to payment of year end bonus accruals.

A decrease in the payable due to Holdings under the TRA due to a change in the effective tax rate.

**Cash Flows**

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

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Cash and cash equivalents decreased \$7.5 million in the three months ended March 31, 2008. Net cash of \$2.6 million was used in operating activities, primarily resulting from a \$7.3 million decrease in accrued compensation and related taxes. Cash of \$0.1 million was used for investing in property and equipment and entering into a non-compete agreement. Financing activities used \$4.7 million of cash primarily due to a \$4.7 million decrease in our warehousing line of credit.

**2007**

Cash and cash equivalents increased \$14.3 million in the three months ended March 31, 2007. Net cash of \$121.7 million was provided by operating activities, primarily resulting from a \$102.5 million decrease in mortgage notes receivable. Cash of \$1.2 million was used for investing in property and equipment. Financing activities used \$106.2 million of cash primarily due to a \$102.5 million decrease in our warehousing line of credit, the payoff of the credit facility in the amount of \$56.3 million and the purchase of partnership interests in HFF LP and HFF Securities and shares of Holliday GP. This decrease in cash was partially offset by the proceeds from the issuance of our Class A common stock of \$272.1 million.

**Liquidity and Capital Resources**

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

Over the three month period ended March 31, 2008, we used approximately \$7.3 million of cash from operations, excluding the funding of Freddie Mac loan closings discussed below. Our short-term liquidity needs are typically related to compensation expenses and other operating expenses such as occupancy, supplies, marketing, professional fees and travel and entertainment. For the three months ended March 31, 2008, we incurred approximately \$33.7 million in total operating expenses. The majority of our operating expenses are variable, highly correlated to our revenue streams and dependent on the collection of transaction fees. During the three months ended March 31, 2008, approximately 43.7% of our operating expenses were variable expenses. In addition, we entered into a tax receivable agreement with HFF Holdings in connection with our initial public offering that provides for the payment by us to HFF Holdings of 85% of the amount of cash savings, if any, in U.S. federal, state and local income tax that we actually realize as a result of the increases in tax basis and as a result of certain other tax benefits arising from our entering into the tax receivable agreement and making payments under that agreement. We have estimated that the payments that will be made to HFF Holdings will be \$113.8 million, of which approximately \$5.8 million will be paid during 2008. Our liquidity needs related to our long term obligations are primarily related to our facility leases. In connection with our initial public offering, we paid off the entire balance of our credit facility of \$56.3 million and entered into a new credit facility that provides us with a \$40.0 million line of credit, as described below. We believe that cash flows from operating activities and the availability under our line of credit will provide adequate liquidity and are sufficient to meet our working capital needs and satisfy our long-term obligations. For the three months ended March 31, 2008, we incurred approximately \$1.9 million in occupancy expenses and approximately \$6,000 in interest expense.

Our cash flow generated from operations historically has been sufficient to enable us to meet our objectives. Assuming current conditions remain unchanged and our pipeline remains at current levels, we believe that cash flows from operating activities should be sufficient for us to fund our current obligations for the foreseeable future. In addition, we maintain and intend to continue to maintain lines of credit that can be utilized should the need arise. In the course of the past several years, we have entered into financing arrangements designed to strengthen our liquidity. Our current principal financing arrangements are described below.

We entered into an Amended Credit Agreement with Bank of America, N.A. for a new \$40.0 million line of credit that was put in place contemporaneously with the consummation of the initial public offering. This new credit facility matures on February 5, 2010 and may be extended for one year based on certain conditions as defined in the agreement. Interest on outstanding balance is payable at the applicable LIBOR rate (for interest periods of one, two, three, six or twelve months) plus 200 basis points, 175 basis points or 150 basis points (such rate is determined from time to time in accordance with the Amended Credit Agreement, based on our then applicable consolidated leverage ratio) or at interest equal to the higher of (a) the Federal Funds Rate (2.51% at March 31, 2008) plus 0.5% and (b) the

Prime Rate (5.25% at March 31, 2008) plus 1.5%. The Amended Credit Agreement also requires payment of a commitment fee of 0.2% or 0.3% on the unused amount of credit based on the total amount outstanding. The Company did not borrow on this revolving credit facility during the three month period ended March 31, 2008.

In 2005, we entered into a financing arrangement with Red Mortgage Capital, Inc. to fund our Freddie Mac loan closings. Pursuant to this arrangement, Red Mortgage Capital funds multifamily Freddie Mac loan closings on a transaction-by-transaction basis, with each loan being separately collateralized by a loan and mortgage on a multifamily property that is ultimately purchased by Freddie Mac.

In October 2007, as a result of increases in the volume of the Freddie Mac loans that HFF LP originates as part of its participation in Freddie Mac's Program Plus Seller Servicer program and recently imposed borrowing limits under the financing arrangement with Red Capital of \$150.0 million, we began pursuing alternative financing arrangements to potentially supplement or replace our existing financing arrangement with Red Capital. On October 30, 2007, we entered into an amendment to the Amended Credit Agreement to clarify that the \$40.0 million line of credit under the Amended Credit Agreement is available to us for purposes of originating such Freddie Mac loans. In addition, in November 2007, we obtained a \$50.0 million financing arrangement from The Huntington National Bank to supplement our Red Capital financing arrangement. As of March 31, 2008, we had outstanding borrowings of \$36.3 million under the Red Capital/Huntington National Bank arrangement and a corresponding amount of mortgage notes receivable. Although we believe that our current financing arrangements with Red Capital

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and The Huntington Bank and our lines of credit under the Amended Credit Agreement are sufficient to meet our current needs in connection with our participation in Freddie Mac's Program Plus Seller Servicer program, in the event we are not able to secure financing for our Freddie Mac loan closings, we will cease originating such Freddie Mac loans until we have available financing.

We regularly monitor our liquidity position, including cash levels, credit lines, interest and payments on debt, capital expenditures and matters relating to liquidity and to compliance with regulatory net capital requirements. We maintain a line of credit under the Amended Credit Agreement in excess of anticipated liquidity requirements. As of March 31, 2008, we had \$40.0 million in undrawn line of credit available to us under this facility. This facility provides us with the ability to meet short-term cash flow needs resulting from our various business activities. If this facility proves to be insufficient or unavailable to us, we would seek additional financing in the credit or capital markets, although we may be unsuccessful in obtaining such additional financing on acceptable terms or at all.

**Critical Accounting Policies; Use of Estimates**

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

*Goodwill.* In accordance with Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets*, we evaluate goodwill for potential impairment annually or more frequently if circumstances indicate impairment may have occurred. In this process, we make estimates and assumptions in order to determine the fair value of the Company. In determining the fair value of the Company for purposes of evaluating goodwill for impairment, we utilize an enterprise market capitalization approach. In applying this approach, we use the closing stock price of our Class A common stock as of the measurement date multiplied by the sum of current outstanding shares plus the exchangeable shares as of the measurement date. As of May 2, 2008, management's analysis indicates that an approximate 75% decline in the Company's stock price may result in the recorded goodwill being impaired and would require management to measure the amount of the impairment charge. Goodwill is considered impaired if the recorded book value of goodwill exceeds the implied fair value of goodwill as determined under this valuation technique. We use our best judgment and information available to us at the time to perform this review. Because our assumptions and estimates are used in projecting future earnings as part of the valuation, actual results could differ.

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

loans being serviced have financial penalties for prepayment or early payoff before the stated maturity date. As a result, the Company has consistently experienced a low level of loan runoff. The estimated value of the servicing rights is impacted by changes in these assumptions. As of March 31, 2008, the fair value and net book value of the servicing rights were \$6.9 million and \$5.7 million, respectively. A 10% and 20% increase in the level of assumed prepayments would decrease the estimated fair value of the servicing rights at the stratum level by up to 1.8% and 3.5%, respectively. A 10% and 20% increase in cost of servicing of the servicing business would decrease the estimated fair value of the servicing rights at the stratum level by up to 10.0% and 20.0%, respectively. A 10% and 20% increase in the discount rate would decrease the estimated fair value of the servicing rights at the stratum level by up to 3.6% and 7.0%, respectively. The effect of a variation in each of these assumptions on the estimated fair value of the servicing rights is calculated independently without changing any other assumption. Servicing rights are amortized in proportion to and over the period of estimated servicing income which results in an accelerated level

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of amortization over eight years. We evaluate amortizable intangible assets on an annual basis, or more frequently if circumstances so indicate, for potential impairment.

*Leases.* The Company leases all of its facilities under operating lease agreements. These lease agreements typically contain tenant improvement allowances. The Company records tenant improvement allowances as a leasehold improvement asset, included in property and equipment, net in the consolidated balance sheet, and a related deferred rent liability and amortizes them on a straight-line basis over the shorter of the term of the lease or useful life of the asset as additional depreciation expense and a reduction to rent expense, respectively. Lease agreements sometimes contain rent escalation clauses or rent holidays, which are recognized on a straight-line basis over the life of the lease in accordance with SFAS No. 13, *Accounting for Leases*. Lease terms generally range from two to ten years. An analysis is performed on all leases to determine whether they should be classified as a capital or an operating lease according to SFAS No. 13, as amended.

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

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

**Seasonality**

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

**Effect of Inflation**

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

**Recent Accounting Pronouncements**

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

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115*. This new standard is designed to reduce complexity in accounting for financial instruments and lessen earnings volatility caused by measuring related assets and liabilities differently. The standard creates presentation and disclosure requirements designed to aid comparisons between companies that use different measurement attributes for similar types of assets and liabilities. The standard, which is expected to expand the use of fair value measurement, permits entities to choose to measure many financial instruments and certain other items at fair value, with unrealized gains and losses on those assets and liabilities recorded in earnings. The fair value option may be applied on a financial instrument by financial instrument basis, with a few exceptions, and is irrevocable for those financial instruments once applied. The fair value option may only be applied to entire financial instruments, not portions of instruments. The standard does not eliminate disclosures

required by SFAS No. 107, *Disclosures About Fair Value of Financial Instruments*, or SFAS No. 157, *Fair Value Measurements*, the latter of which is described below. The provisions of the standard are effective for consolidated financial statements beginning January 1, 2008. The Company did not elect the fair value option upon adoption of SFAS 159 on January 1, 2008.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157). This new standard defines fair value, establishes a framework for measuring fair value in conformity with GAAP, and expands disclosures about fair value measurements. Prior to this standard, there were varying definitions of fair value, and the limited guidance for applying those definitions under GAAP was dispersed among the many accounting pronouncements that require fair value measurements. The new standard defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the



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measurement date. The provisions of SFAS 157 were adopted on January 1, 2008, and did not have a material impact on our consolidated financial position or results of operations.

The standard applies under other accounting pronouncements that require or permit fair value measurements, since the FASB previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. As a result, the new standard does not establish any new fair value measurements itself, but applies to other accounting standards that require the use of fair value for recognition or disclosure. In particular, the framework in the new standard will be required for financial instruments for which fair value is elected.

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

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

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

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

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

The standard is intended to increase consistency and comparability in fair value measurements and disclosures about fair value measurements, and encourages entities to combine the fair value information disclosed under the standard with the fair value information disclosed under other accounting pronouncements, including SFAS No. 107, *Disclosures about Fair Value of Financial Instruments*, where practicable. The provisions of this standard were effective beginning January 1, 2008.

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

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

Due to the nature of our business and the manner in which we conduct our operations, in particular that our financial instruments which are exposed to concentrations of credit risk consist primarily of short-term cash investments, we believe we do not face any material interest rate risk, foreign currency exchange rate risk, equity price risk or other market risk.

**Item 4. Controls and Procedures*****Management's Quarterly Evaluation of Disclosure Controls and Procedures***

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the reports that the Company files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required financial disclosure.

Our Chief Executive Officer and Chief Financial Officer (our principal executive officer and principal financial officer, respectively) have evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our principal executive officer and principal financial officer have concluded that, as of March 31, 2008, the Company's disclosure controls and procedures are effective to

provide reasonable assurance that material information required to be included in our periodic SEC reports is recorded, processed, summarized and reported within the time periods specified in rules and forms.

The design of any system of control is based upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated objectives under all future events, no matter how remote, or that the degree of compliance with the policies or procedures may not deteriorate. Because of its inherent limitations, disclosure controls and procedures may not prevent or detect all misstatements. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives.

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***Changes in Internal Controls***

There were no changes in our internal control over financial reporting that occurred during the three month period covered by this report that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings.**

We are party to various litigation matters, in most cases involving normal ordinary course and routine claims incidental to our business. We cannot estimate with certainty our ultimate legal and financial liability with respect to such pending matters. However, we believe, based on our examination of such pending matters, that our ultimate liability for such matters will not have a material adverse effect on our business or financial condition.

**Item 1A. Risk Factors.**

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors, in our Annual Report on Form 10-K for the year ended December 31, 2007, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

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

None.

**Item 3. Defaults Upon Senior Securities.**

None.

**Item 4. Submission of Matters to a Vote of Security Holders.**

None.

**Item 5. Other Information.**

None.

**Item 6. Exhibits.**

A. Exhibits

31.1 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).

31.2 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).

32.1 Certification pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).

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**SIGNATURES**

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

HFF, INC.

Dated: May 9, 2008

By: /s/ John H. Pelusi, Jr.  
John H. Pelusi, Jr  
*Chief Executive Officer, Director and  
Executive Managing Director  
(Principal Executive Officer)*

Dated: May 9, 2008

By: /s/ Gregory R. Conley  
Gregory R. Conley  
*Chief Financial Officer  
(Principal Financial and Accounting  
Officer)*

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**EXHIBIT INDEX**

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