HFF, Inc.
Form 10-Q
May 04, 2012
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2012

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	**51-0610340**
(State of Incorporation)	**(I.R.S. Employer Identification No.)**
One Oxford Centre	
301 Grant Street, Suite 600	
Pittsburgh, Pennsylvania	**15219**
(Address of Principal Executive Offices)	**(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 þ No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ 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 þ
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	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 þ

Number of shares of Class A common stock, par value $0.01 per share, of the registrant outstanding as of April 27, 2012 was 36,911,900 shares.

Table of Contents

HFF, INC. AND SUBSIDIARIES

TABLE OF CONTENTS

March 31, 2012

	Page
PART I. FINANCIAL INFORMATION	3
Item 1. Financial Statements	3
Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations	23
Item 3. Quantitative and Qualitative Disclosures about Market Risk	34
Item 4. Controls and Procedures	34
PART II. OTHER INFORMATION	35
Item 1. Legal Proceedings	35
Item 1A. Risk Factors	35
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	35
Item 3. Defaults upon Senior Securities	35
Item 4. Mine Safety Disclosures	35
Item 5. Other Information	35
Item 6. Exhibits	35
Signatures	36
Certification Pursuant to Section 302	
Certification Pursuant to Section 302	
Certification Pursuant to Section 1350	

Table of Contents

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, seeks, approximately, predicts, intends, plans, estimates, anticipates these words or other comparable words. Such forward-looking statements are subject to various risks and uncertainties. Accordingly, there are or will be important factors that could cause actual outcomes or results to differ materially from those indicated in these statements. We believe these factors include, but are not limited to, those described under the caption Risk Factors in our Annual Report on Form 10-K and this Quarterly Report on Form 10-Q. These factors should not be construed as exhaustive and should be read in conjunction with the other cautionary statements that are included in this Quarterly Report on Form 10-Q. We undertake no obligation to publicly update or review any forward-looking statement, whether as a result of new information, future developments or otherwise.

SPECIAL NOTE REGARDING THE REGISTRANT

In connection with our initial public offering of our Class A common stock in February 2007, we effected a reorganization of our business, which had previously been conducted through HFF Holdings LLC (HFF Holdings) and certain of its wholly-owned subsidiaries, including Holliday Fenoglio Fowler, L.P. and HFF Securities L.P. (together, the Operating Partnerships) and Holliday GP Corp. (Holliday GP). In the reorganization, HFF, Inc., a newly-formed Delaware corporation, purchased from HFF Holdings all of the shares of Holliday GP, which is the sole general partner of each of the Operating Partnerships, and approximately 44.7% of the partnership units in each of the Operating Partnerships (including partnership units in the Operating Partnerships held by Holliday GP) in exchange for the net proceeds from the initial public offering and one share of Class B common stock of HFF, Inc. As of March 31, 2012, HFF Holdings had exchanged an additional approximately 54.9% of the partnership units in each of the Operating Partnerships for shares of Class A common stock of the Company pursuant to the Exchange Right (as defined in this Quarterly Report on Form 10-Q). Following this reorganization, HFF, Inc. became and continues to be a holding company holding partnership units in the Operating Partnerships and all of the outstanding shares of Holliday GP. As of March 31, 2012, HFF, Inc. held approximately 99.6% of the partnership units in the Operating Partnerships. 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., a Delaware corporation and its consolidated subsidiaries, after giving effect to the Reorganization Transactions.

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

HFF, Inc.

Consolidated Balance Sheets

(Dollars in Thousands)

	March 31, 2012 (unaudited)	December 31, 2011 (audited)
ASSETS		
Current assets:		
Cash and cash equivalents	**$ 125,820**	$ 141,763
Restricted cash *(Note 7)*	**80**	80
Accounts receivable	**2,020**	1,411
Receivable from affiliate *(Note 16)*	**229**	223
Mortgage notes receivable *(Note 8)*	**139,051**	154,449
Prepaid taxes	**3,322**	79
Prepaid expenses and other current assets	**2,663**	2,205
Deferred tax asset, net	**1,235**	4,556
Total current assets, net	**274,420**	304,766
Property and equipment, net *(Note 4)*	**5,387**	4,315
Deferred tax asset, net	**157,486**	151,224
Goodwill	**3,712**	3,712
Intangible assets, net *(Note 5)*	**13,667**	13,137
Other noncurrent assets	**1,222**	1,297
Total Assets	**$ 455,894**	$ 478,451
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Current portion of long-term debt *(Note 7)*	**$ 316**	$ 269
Warehouse line of credit *(Note 8)*	**139,051**	154,449
Accrued compensation and related taxes	**17,040**	30,828
Accounts payable	**1,166**	1,670
Payable under tax receivable agreement *(Note 12)*	**17,876**	17,876
Other current liabilities	**3,014**	7,227
Total current liabilities	**178,463**	212,319
Deferred rent credit	**4,504**	3,508
Payable under the tax receivable agreement, less current portion *(Note 12)*	**136,248**	131,924
Other long-term liabilities		
Long-term debt, less current portion *(Note 7)*	**351**	300
Total liabilities	**319,566**	348,051
Stockholders equity:		
Class A common stock, par value $0.01 per share, 175,000,000 authorized; 37,069,517 and 36,102,322 shares issued, respectively; 36,911,900 and 35,983,965 shares outstanding, respectively	**369**	360
Class B common stock, par value $0.01 per share, 1 share authorized, and 1 share outstanding		

Treasury stock, 157,617 and 118,357 shares at cost, respectively	**(1,055)**	(490)
Additional paid-in-capital	**70,260**	64,049
Retained earnings	**66,190**	62,914
Total parent stockholders equity	**135,764**	126,833
Noncontrolling interest *(Note 13)*	**564**	3,567
Total equity	**136,328**	130,400
Total liabilities and stockholders equity	**$ 455,894**	$ 478,451

See accompanying notes to the consolidated financial statements.

Table of Contents

HFF, Inc.

Consolidated Statements of Income

(Dollars in Thousands, except per share data)

	Three Months Ended March 31, 2012	2011
Revenues		
Capital markets services revenue	**$ 50,555**	$ 40,469
Interest on mortgage notes receivable	**991**	1,076
Other	**332**	391
	51,878	41,936
Expenses		
Cost of services	**32,367**	25,410
Personnel	**6,784**	4,297
Occupancy	**1,856**	1,925
Travel and entertainment	**1,772**	1,307
Supplies, research, and printing	**1,476**	903
Insurance	**423**	402
Professional fees	**991**	941
Depreciation and amortization	**1,516**	955
Interest on warehouse line of credit	**648**	647
Other operating	**1,289**	838
	49,122	37,625
Operating income	**2,756**	4,311
Interest and other income, net	**2,836**	2,867
Interest expense	**(9)**	(10)
(Increase) decrease in payable under the tax receivable agreement	**(9)**	
Income before income taxes	**5,574**	7,168
Income tax expense	**2,177**	2,821
Net income	**3,397**	4,347
Net income attributable to noncontrolling interest	**121**	298
Net income attributable to controlling interest	**$ 3,276**	$ 4,049
Earnings per share Basic and Diluted		
Income available to HFF, Inc. common stockholders Basic	**$ 0.09**	$ 0.11
Income available to HFF, Inc. common stockholders Diluted	**$ 0.09**	$ 0.11

See accompanying notes to the consolidated financial statements.

Table of Contents

HFF, Inc.

Consolidated Statements of Stockholders Equity

(Dollars in Thousands, except share data)

	Common Stock		Controlling Interest Treasury Stock		Additional Paid in Capital	Retained Earnings	Noncontrolling Interest	Total Equity
	Shares	Amount	Shares	Amount				
Stockholders equity, December 31, 2011	35,983,965	$ 360	118,357	$ (490)	$ 64,049	$ 62,914	$ 3,567	$ 130,400
Stock compensation and other, net					2,336			2,336
Issuance of Class A common stock, net (1)	967,195	9			3,115		(3,124)	
Repurchase of Class A common stock	(39,260)	( )	39,260	(565)				(565)
Record the adjustment to give effect of the tax receivable agreement with HFF Holdings					760			760
Distributions								
Net income						3,276	121	3,397
Stockholders equity, March 31, 2012	36,911,900	$ 369	157,617	$ (1,055)	$ 70,260	$ 66,190	$ 564	$ 136,328

Consolidated Statements of Stockholders' Equity

	Common Stock		Controlling Interest Treasury Stock		Additional Paid in Capital	Retained Earnings	Noncontrolling Interest	Total Equity
	Shares	Amount	Shares	Amount				
Stockholders equity, December 31, 2010	34,829,382	$ 348	110,540	$ (396)	$ 62,485	$ 22,895	$ 4,351	$ 89,683
Stock compensation and other, net					159			159
Issuance of Class A common stock, net (1)	1,136,956	12			2,336		(2,348)	
Repurchase of Class A common stock	(7,817)	( )	7,817	(94)				(94)
Record the adjustment to give effect of the tax receivable agreement with HFF Holdings					877			877
Distributions								
Net income						4,049	298	4,347
Stockholders equity, March 31, 2011	35,958,521	$ 360	118,357	$ (490)	$ 65,857	$ 26,944	$ 2,301	$ 94,972

(1) Includes the effect of the exchange of the Operating Partnerships units by HFF Holdings and the effect of the timing of the tax distribution payments on the ownership of the Operating Partnerships.

See accompanying notes to the consolidated financial statements.

Table of Contents

HFF, Inc.

Consolidated Statements of Cash Flows

(Dollars In Thousands)

	Three Months Ended March 31, 2012	2011
Operating activities		
Net income	**$ 3,397**	$ 4,347
Adjustments to reconcile net income to net cash used in operating activities:		
Stock based compensation	**1,649**	623
Deferred taxes	**2,135**	2,743
Increase (decrease) in payable under the tax receivable agreement	**9**	
Depreciation and amortization:		
Property and equipment	**658**	307
Intangibles	**858**	648
Gain on sale or disposition of assets, net	**(1,364)**	(1,945)
Mortgage service rights assumed	**(521)**	(296)
Proceeds from sale of mortgage servicing rights	**528**	898
Increase (decrease) in cash from changes in:		
Accounts receivable	**(609)**	(623)
Receivable from affiliates	**(6)**	(1)
Mortgage notes receivable	**15,398**	(3,403)
Net borrowings on warehouse line of credit	**(15,398)**	3,403
Prepaid taxes, prepaid expenses and other current assets	**(3,701)**	(725)
Other noncurrent assets	**75**	23
Accrued compensation and related taxes	**(13,101)**	(4,992)
Accounts payable	**(504)**	(299)
Other accrued liabilities	**(4,213)**	(1,391)
Other long-term liabilities	**995**	119
Net cash used in operating activities	**(13,715)**	(564)
Investing activities		
Purchases of property and equipment	**(1,588)**	(274)
Net cash used in investing activities	**(1,588)**	(274)
Financing activities		
Payments on long-term debt	**(75)**	(58)
Treasury stock	**(565)**	(94)
Net cash used in financing activities	**(640)**	(152)
Net decrease in cash	**(15,943)**	(990)
Cash and cash equivalents, beginning of period	**141,763**	73,339
Cash and cash equivalents, end of period	**$ 125,820**	$ 72,349

See accompanying notes to the consolidated financial statements.

Table of Contents

HFF, Inc.

Notes to Consolidated Financial Statements

1. Organization and Basis of Presentation

Organization

HFF, Inc., a Delaware corporation (the Company), through its Operating Partnerships, Holliday Fenoglio Fowler, L.P., a Texas limited partnership (HFF LP), and HFF Securities L.P., a Delaware limited partnership and registered broker-dealer (HFF Securities and together with HFF LP, the Operating Partnerships), is a commercial real estate financial intermediary and provides commercial real estate and capital markets services including debt placement, investment sales, structured finance, private equity placements, investment banking and advisory services, loan sales and loan sale advisory services, commercial loan servicing, commercial real estate structured financing placements and capital markets advice in 20 offices in the United States.

Initial Public Offering and Reorganization

The Company was formed in November 2006 in connection with a proposed initial public offering of its Class A common stock. On November 9, 2006, 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 Offering were used to purchase from HFF Holdings LLC, a Delaware limited liability company (HFF Holdings), all of the shares of Holliday GP Corp. and partnership units representing approximately 39% of each of the Operating Partnerships (including partnership units in the Operating Partnerships held by Holliday GP).

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

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

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

Basis of Presentation

The accompanying consolidated financial statements of HFF, Inc. as of March 31, 2012 and December 31, 2011 and for the three month periods ended March 31, 2012 and March 31, 2011, include the accounts of HFF LP, HFF Securities, and HFF, Inc. s wholly-owned subsidiaries, Holliday GP and HoldCo LLC. All significant intercompany accounts and transactions have been eliminated.

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

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, 2011. 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, 2012 are not necessarily indicative of the results expected for the year ending December 31, 2012.

In late 2010, the Company introduced a firm profit participation plan and modified the existing office profit participation plans to allow for the incentive payments to be made either in the form of cash or stock at the election of the Company s board of directors based on achieving various performance metrics. The new and modified plans took effect during 2011. The expense associated with the plans is included within personnel expenses in the consolidated statements of income. The expense recorded for these plans is estimated during the year based on actual results at each interim reporting date and an estimate of future results for the remainder of the year. The plans allow for payments to be made in both cash and share-based awards, the composition of which is determined in the first calendar quarter of the subsequent year. Cash and share-based awards issued under these plans are subject to vesting conditions over the subsequent year, such that the total expense measured for these plans is recorded over the period from the beginning of the performance year through the vesting date. Based on an accounting policy election, the expense associated with the stock component of the estimated incentive payout is recognized before the grant date of the stock due to the fact that the terms of the incentive compensation plans have been approved by the Company s board of directors and the employees of the Company understand the requirements to earn the award. Prior to the grant date, the share-based component-related expense is recorded as incentive compensation expense within personnel expenses in the Company s consolidated statements of income. Following the award, if any, of the related incentive payout, the share-based component expense is reclassified as stock compensation costs within personnel expenses. Additionally, the share-based component of the accrued incentive compensation is reclassified as additional paid-in-capital upon the granting of the awards on the Company s consolidated balance sheets.

3. Stock Compensation

The stock compensation cost that has been charged against income for the three months ended March 31, 2012 and 2011 was $1.6 million and $0.6 million, respectively, which is recorded in personnel expenses in the consolidated statements of income. At March 31, 2012, there was approximately $5.2 million of unrecognized compensation cost related to share based awards. As of March 31, 2012, there were 591,379 restricted stock units outstanding, of which 387,335 units are treated as liability awards and require remeasurement of fair value at the end of each reporting period until settlement. Stock compensation expense related to the liability awards that has been included within income for the three months ended March 31, 2012 and 2011 was $1.2 million and $0.5 million, respectively.

During the three months ended March 31, 2012, no options were granted, vested, exercised or forfeited.

During the three month period ending March 31, 2012, 236,897 new restricted stock units were granted, 121,248 restricted stock units vested and were converted to Class A common stock and 5,365 restricted stock units were forfeited. Of the 236,897 new restricted stock units granted during the three month period ending March, 31, 2012, $1.9 million of costs associated with 212,259 of these stock units were recognized in income during 2011 pursuant to the Company s accounting policy election regarding the firm and office profit participation plans as further discussed in Note 2. Additionally, $1.9 million of the share-based component of the accrued incentive compensation that was paid in the form of restricted shares was reclassified to additional paid-in-capital on the Company s consolidated balance sheets.

The fair value of vested restricted stock units was $1.5 million at March 31, 2012.

9

Table of Contents

The weighted average remaining contractual term of the nonvested restricted stock units was 1.6 years as of March 31, 2012.

4. Property and Equipment

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

	March 31, 2012	December 31, 2011
Furniture and equipment	**$ 4,519**	$ 4,294
Computer equipment	**853**	852
Capitalized software costs	**496**	496
Leasehold improvements	**7,947**	6,617
Subtotal	**13,815**	12,259
Less accumulated depreciation and amortization	**(8,428)**	(7,944)
	$ 5,387	$ 4,315

At March 31, 2012 and December 31, 2011 the Company has recorded, within furniture and equipment, office equipment under capital leases of $1.0 million and $0.8 million, respectively, including accumulated amortization of $0.3 million and $0.3 million, respectively, which is included within depreciation and amortization expense in the accompanying consolidated statements of income. See Note 7 for discussion of the related capital lease obligations.

5. Intangible Assets

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

	March 31, 2012			December 31, 2011		
	Gross Carrying Amount	Accumulated Amortization	Net Book Value	Gross Carrying Amount	Accumulated Amortization	Net Book Value
Amortizable intangible assets:						
Mortgage servicing rights	**$ 23,695**	**$ (10,128)**	**$ 13,567**	$ 22,338	$ (9,301)	$ 13,037
Unamortizable intangible assets:						
FINRA license	**100**		**100**	100		100
Total intangible assets	**$ 23,795**	**$ (10,128)**	**$ 13,667**	$ 22,438	$ (9,301)	$ 13,137

As of March 31, 2012 and December 31, 2011, the Company serviced $28.2 billion and $27.2 billion, respectively, of commercial loans. The Company earned $3.2 million and $3.0 million in servicing fees and interest on float and escrow balances for the three month periods ending March 31, 2012 and 2011, respectively. These revenues are recorded as capital markets services revenues in the consolidated statements of income.

The total commercial loan servicing portfolio includes loans for which there are no corresponding mortgage servicing rights recorded on the balance sheet, as these servicing rights were assumed prior to January 1, 2007 and involved no initial consideration paid by the Company. The Company recorded mortgage servicing rights of $13.6 million and $13.0 million on $20.0 billion and $18.7 billion, respectively, of the total loans serviced as of March 31, 2012 and December 31, 2011.

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

Mortgage servicing rights do not trade in an active, open market with readily-available observable prices. Since there is no ready market value for the mortgage servicing rights, such as quoted market prices or prices based on sales or purchases of similar assets, the Company determines the fair value of the mortgage servicing rights by estimating the present value of future cash flows associated with the servicing of the loans. Management makes certain assumptions and judgments in estimating the fair value of servicing rights, 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, 2012 and 2011 are as follows:

Table of Contents

	As of March 31,	
	2012	2011
Expected life of cash flows	3 years to 10 years	3 years to 10 years
Discount rate (1)	15% to 20%	15% to 20%
Prepayment rate	0% to 8%	0% to 8%
Inflation rate	2%	2%
Cost of service per loan	$1,600 to $3,983	$1,600 to $3,800

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

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

Changes in the carrying value of mortgage servicing rights for the three month periods ended March 31, 2012 and 2011, and the fair value at the end of each period were as follows (dollars in thousands):

Category	12/31/11	Capitalized	Amortized	Sold / Transferred	3/31/12	FV at 3/31/12
Freddie Mac	$ 6,126	$ 958	$ (353)	$ (447)	$ 6,284	$ 6,502
CMBS	5,273	157	(265)	356	5,521	6,515
Life company	1,492	243	(217)		1,518	1,657
Life company limited	146	121	(23)		244	306
Total	$ 13,037	$ 1,479	$ (858)	$ (91)	$ 13,567	$ 14,980

Category	12/31/10	Capitalized	Amortized	Sold / Transferred	3/31/11	FV at 3/31/11
Freddie Mac	$ 6,190	$ 1,127	$ (325)	$ (475)	$ 6,517	$ 7,226
CMBS	3,232	116	(156)	385	3,577	4,166
Life company	900	172	(153)		919	975
Life company limited	91	8	(20)		79	131
Total	$ 10,413	$ 1,423	$ (654)	$ (90)	$ 11,092	$ 12,498

Amounts capitalized represent mortgage servicing rights retained upon the sale of originated loans to Freddie Mac and mortgage servicing rights acquired without the exchange of initial consideration. The Company recorded mortgage servicing rights retained upon the sale of originated loans to Freddie Mac of $1.0 million and $1.1 million on $337.0 million and $402.2 million of loans, respectively, during the three month periods ending March 31, 2012 and 2011, respectively. The Company recorded mortgage servicing rights acquired without the exchange of initial consideration of $0.5 million and $0.3 million on $1.4 billion and $812.0 million of loans, respectively, during the three month periods ending March 31, 2012 and 2011, respectively. During the three months ending March 31, 2012 and 2011, the Company sold the cashiering portion of certain Freddie Mac mortgage servicing rights. While the Company transferred the risks and rewards of ownership of the cashiering portion of the mortgage servicing rights, the Company continues to perform limited servicing activities on these loans for a reduced market-based fee. Therefore, the remaining servicing rights were transferred to the CMBS servicing tranche. The net result of these transactions was the Company recording a gain in the three months ending March 31, 2012 and 2011 of $0.4 million and $0.8 million, respectively, within interest and other income, net in the consolidated statements of income. The Company also received securitization compensation in relation to the sale of the cashiering portion of certain Freddie Mac mortgage servicing rights in the three ending March 31, 2012 and 2011 of $0.4 million and $0.4 million, respectively. The securitization compensation is recorded within interest and other income, net in the consolidated statements of income.

Amortization expense related to intangible assets was $0.9 million and $0.7 million during the three month periods ended March 31, 2012 and 2011, respectively, and is recorded in depreciation and amortization in the consolidated statements of income.

Table of Contents

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

Remainder of 2012	$ 2,591
2013	3,011
2014	2,446
2015	1,811
2016	1,498
2017	1,130

The weighted-average life of the mortgage servicing rights intangible asset was 5.7 years at March 31, 2012.

6. Fair Value Measurement

The Company adopted ASC 820 as of January 1, 2008. ASC 820 establishes a valuation hierarchy for disclosure of the inputs to valuation used to measure fair value. This hierarchy prioritizes the inputs into the following three levels: Level 1 inputs which are quoted market prices in active markets for identical assets or liabilities; Level 2 inputs which are observable market-based inputs or unobservable inputs corroborated by market data for the asset or liability; and Level 3 inputs which are unobservable inputs based on management s assumptions that are not corroborated by market data. A financial asset or liability s classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

As of March 31, 2012, the Company did not have any assets or liabilities recognized at fair value on a recurring basis.

In accordance with generally accepted accounting principles, from time to time, the Company measures certain assets at fair value on a nonrecurring basis. These assets may include mortgage servicing rights and mortgage notes receivable. The mortgage servicing rights are recorded at fair value upon initial recording and were not re-measured at fair value during the first quarter of 2012 as the Company continues to utilize the amortization method under ASC 860 and the fair value of the mortgage servicing rights exceeds the carrying value at March 31, 2012. 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, 2012. Therefore, no lower of cost or fair value adjustment was required.

7. Capital Lease Obligations and Letters of Credit

(a) Capital Lease Obligations

Capital lease obligations consist of the following at March 31, 2012 and December 31, 2011 (dollars in thousands):

	March 31, 2012	December 31, 2011
Capital lease obligations	**$ 667**	$ 569
Less current maturities	**316**	269
	$ 351	$ 300

Capital lease obligations consist primarily of office equipment leases that expire at various dates through February 2017. A summary of future minimum lease payments under capital leases at March 31, 2012 is as follows (dollars in thousands):

Remainder of 2012	$ 238
2013	248
2014	148

2015	16
2016	12
2017	5
	$ 667

12

Table of Contents

(b) Letters of Credit

At each March 31, 2012 and December 31, 2011, the Company had one outstanding letter of credit of approximately $0.1 million as security for one lease. The Company segregated the cash in a separate bank account to collateralize the letter of credit. The letter of credit expires in October 2012, however, the underlying lease to which this letter of credit relates was terminated in March 2012 and the letter of credit is anticipated to be released and funds returned to the Company in the second quarter of 2012.

8. Warehouse Line of Credit

HFF LP maintains two uncommitted warehouse revolving lines of credit for the purpose of funding the Freddie Mac mortgage loans that it originates in connection with its services as a Freddie Mac Multifamily Program Plus® Seller/Servicer. On April 23, 2012, HFF LP entered into a fourth amended and restated line of credit with The Huntington Bank (Huntington) which provides for an additional $25 million of availability ($100 million in total), upon election of the Company, for a four consecutive month period commencing after June 30, 2012 and ending no later than December 31, 2012. During December 2009, HFF LP also entered into an agreement with PNC Bank, N.A. (PNC) to replace a separate predecessor warehouse revolving line of credit. HFF LP s line of credit with PNC provided $175 million of availability. In May 2011, availability under the PNC line increased to $250 million.

Each funding is separately approved on a transaction-by-transaction basis and is collateralized by a loan and mortgage on a multifamily property that is ultimately purchased by Freddie Mac. As of March 31, 2012 and December 31, 2011, HFF LP had $139.1 million and $154.4 million, respectively, outstanding on the warehouse lines of credit and a corresponding amount of mortgage notes receivable. Interest on the warehouse lines of credit is at the 30-day LIBOR rate (0.24% and 0.28% at March 31, 2012 and December 31, 2011, respectively) plus a spread. HFF LP is also paid interest on its loan secured by a multifamily loan at the rate in the Freddie Mac note.

9. Lease Commitments

The Company leases various corporate offices and office equipment under noncancelable operating leases. These leases have initial terms of one to ten years. Several of the leases have termination clauses whereby the term may be reduced by two to seven years upon prior notice and payment of a termination fee by the Company. Total rental expense charged to operations was $1.4 million and $1.5 million during the three month periods ended March 31, 2012 and 2011, respectively and is recorded within occupancy expense in the consolidated statements of income.

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

Remainder of 2012	$ 4,038
2013	5,437
2014	4,288
2015	3,498
2016	2,781
2017	2,165
Thereafter	4,900
	$ 27,107

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

The Company also leases certain office equipment under capital leases that expire at various dates through 2017. See Note 4 and Note 7 above for further description of the assets and related obligations recorded under these capital leases at March 31, 2012 and December 31, 2011, respectively.

10. Servicing

The Company services commercial real estate loans for investors. The unpaid principal balance of the servicing portfolio totaled $28.2 billion and $27.2 billion at March 31, 2012 and December 31, 2011, respectively.

Table of Contents

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, 2012 and December 31, 2011, the funds held in escrow totaled $106.5 million and $126.6 million, respectively. These funds, and the offsetting liabilities of the borrowers to external parties, are not presented in the Company s consolidated financial statements as they do not represent the assets and liabilities of the Company. Pursuant to the requirements of the various investors for which the Company services loans, the Company maintains bank accounts, holding escrow funds, which have balances in excess of the FDIC insurance limit. The fees earned on these escrow funds are reported in capital markets services revenue in the consolidated statements of income.

11. Legal Proceedings

The Company is party to various litigation matters, in most cases involving ordinary course and routine claims incidental to its business. The Company cannot estimate with certainty its ultimate legal and financial liability with respect to any pending matters. In accordance with ASC 450, *Contingencies,* a reserve for estimated losses is recorded when the amount is probable and can be reasonably estimated. However, the Company does not believe, based on examination of such pending matters, that a material loss related to these matters is reasonably possible.

12. Income Taxes

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

	Current	Deferred	Total
Three Months Ended March 31, 2012:			
Federal	$	$ 1,882	$ 1,882
State	42	253	295
	$ 42	$ 2,135	$ 2,177

	Current	Deferred	Total
Three Months Ended March 31, 2011:			
Federal	$	$ 2,497	$ 2,497
State	78	246	324
	$ 78	$ 2,743	$ 2,821

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, 2012 and 2011 (dollars in thousands):

	March 31, 2012	March 31, 2011
Pre-tax book income	**$ 5,574**	$ 7,168
Less: pre-tax income allocated to noncontrolling interest holder	**122**	300
Pre-tax book income after noncontrolling interest	**$ 5,452**	$ 6,868

	March 31,			
	2012		2011	
Income tax expense / (benefit)		**Rate**		**Rate**
Taxes computed at federal rate	**$ 1,908**	**35.0%**	$ 2,404	35.0%
State and local taxes, net of federal tax benefit	**228**	**4.2%**	321	4.7%
Change in income tax benefit payable to stockholder	**(3)**	**(0.1)%**		0.0%
Stock compensation		**0.0%**	41	0.6%
Meals and entertainment	**43**	**0.8%**	49	0.7%
Other	**1**	**0.0%**	6	0.1%
Income tax expense	**$ 2,177**	**39.9%**	$ 2,821	41.1%

Total income tax expense recorded for the three months ended March 31, 2012 and 2011 included income tax expense of $1,000 and $3,000, respectively, of state and local taxes on income allocated to the noncontrolling interest holder, which represents 0.02% and 0.04% of the total effective rate, respectively.

Deferred income tax assets and liabilities consist of the following at March 31, 2012 and December 31, 2011 (dollars in thousands):

	March 31, 2012	December 31, 2011
Deferred income tax assets:		
Section 754 election tax basis step-up	**$ 179,534**	$ 176,365
Tenant improvements	**2,036**	1,882
Net operating loss carryforward	**4,386**	1,144
Restricted stock units	**1,898**	1,144
Compensation	**992**	4,369
Intangible asset	**162**	857
Tax credits	**123**	123
Other	**343**	205
	189,474	186,089
Less: valuation allowance	**(22,525)**	(21,902)
Deferred income tax asset	**166,949**	164,187
Deferred income tax liabilities:		
Goodwill	**(1,278)**	(1,248)
Servicing rights	**(5,151)**	(4,829)
Deferred rent	**(1,625)**	(1,473)
Investment in partnership	**(174)**	(857)
Deferred income tax liability	**(8,228)**	(8,407)
Net deferred income tax asset	**$ 158,721**	$ 155,780

The primary deferred tax asset represents a tax basis step-up election under Section 754 of the Internal Revenue Code (Section 754) made by HFF, Inc. relating to the initial purchase of units of the Operating Partnerships in connection with the Reorganization Transactions and a tax basis step-up on subsequent exchanges of Operating Partnership units for shares of the Company s Class A common stock since the date of the Reorganization Transactions. As a result of the step-up in basis from these transactions, the Company is entitled to annual future tax benefits in the form of amortization for income tax purposes. During the three month period ending March 31, 2012, the deferred tax asset for the Section 754 election tax basis step-up increased $5.1 million due to the exchanges of Operating Partnership units for the Company s Class A common stock. The annual pre-tax benefit is approximately $26.3 million at March 31, 2012 and will increase as future exchanges of Operating Partnership units occur (see Note 13). To the extent that the Company does not have sufficient taxable income in a year to fully utilize this annual deduction, the unused benefit is recharacterized as a net operating loss and can then be carried back three years or carried forward for twenty years. The Company measured the deferred tax asset based on the estimated income tax effects of the increase in the tax basis of the assets owned by the Operating Partnerships utilizing the enacted tax rates at the date of the transaction. In accordance with ASC topic 740,

Income Taxes (ASC 740), the tax effects of transactions with stockholders that result in changes in the tax basis of a company s assets and liabilities are recognized in equity. The Company recorded a valuation allowance on a portion of the recognized deferred tax assets recorded in connection with the Reorganization Transactions and the subsequent exercise of exchange rights due to the uncertainty in the timing and level of tax benefits that would be realized when payments are made to HFF Holdings under the tax receivable agreement (see further discussion below). Changes in the measurement of the deferred tax assets or the valuation allowance due to changes in the enacted tax rates upon the finalization of the income tax returns for the year of the exchange transaction will be recorded in equity. All subsequent changes in the measurement of the deferred tax assets due to changes in the enacted tax rates or changes in the valuation allowance are recorded as a component of income tax expense.

In evaluating the realizability of the deferred tax assets, management makes estimates and judgments regarding the level and timing of future taxable income, including projecting future revenue growth and changes to the cost structure. In order to realize the annual pre-tax benefit of approximately $26.3 million, the Company needs to generate approximately $169.0 million in revenue each year, assuming a constant cost structure. In the event that the Company cannot realize the annual pre-tax benefit of $26.3 million each year, the shortfall becomes a net operating loss that can be carried back three years to offset prior years taxable income or carried forward twenty years to offset future taxable income. Based on this analysis and other quantitative and qualitative factors, management believes that it is currently more likely than not that the Company will be able to generate sufficient taxable income to realize the net deferred tax assets resulting from the basis step up transactions (initial sale of units in the Operating Partnerships and subsequent exchanges of Operating Partnership units since the date of the Reorganization Transactions). Deferred tax assets representing the tax benefits to be realized when future payments are made to HFF Holdings under the tax receivable agreement of $22.5 million are currently not more likely than not to be realized and, therefore, have a valuation allowance of $22.5 million recorded against them. The combined federal and state tax effected net operating loss carryforwards of $4.4 million at March 31, 2012 represent the cumulative excess of the Section 754 annual tax deductions over taxable income for the three month period ending March 31, 2012 and prior years. A portion of the net operating loss of $4.4 million is subject to limitation under Section 382 of the Internal Revenue Code. The limitation on the use of the net operating loss in 2012 is $1.1 million, which can be used in future years. The net operating loss limitation does not impact the Company s ability to fully utilize the net operating loss before its expiration. The federal net operating loss carryforwards expire from 2028 through 2030, while the state net operating loss carryforwards expire from 2013 through 2030.

The Company will recognize interest and penalties related to unrecognized tax benefits in interest and other income, net in the consolidated statements of income. There were no interest or penalties recorded in the three month periods ending March 31, 2012 and 2011.

Tax Receivable Agreement

In connection with the Reorganization Transactions, HFF LP and HFF Securities made an election under Section 754 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 and subsequent exchanges of Operating Partnership units for shares of Class A common stock produced (and future exchanges may produce) increases in 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 tax payments to the extent that the Company has taxable income. During the three month period ending March 31, 2012, the deferred tax asset for the Section 754 election tax basis step-up increased $5.1 million due to the exchanges of Operating Partnership units for the Company s Class A common stock. As a result of the increase in tax basis, the Company is entitled to future tax benefits of $179.5 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 2011. 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 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 is 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 subsequent 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 ASC 740, the tax effects of transactions with stockholders that result in changes in the tax basis of a company s assets and liabilities will be recognized in equity. If transactions with stockholders 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. Subsequent changes in enacted tax rates or any valuation allowance are recorded as a component of income tax expense.

The Company believes it is more likely than not that it will realize a portion of the benefit represented by the deferred tax asset, and, therefore, the Company recorded 85% of this estimated amount of the increase in deferred tax assets as a liability to HFF Holdings under the tax receivable agreement and the remaining 15% of the increase in deferred tax assets directly in additional paid-in capital in stockholders equity. However, due to uncertainties of timing and amounts of payments, deferred tax assets representing the tax benefits to be realized when future payments are made to HFF Holdings under the tax receivable agreement are currently not more likely than not to be realized and, therefore, have a valuation allowance of $22.5 million recorded against them.

While the actual amount and timing of payments under the tax receivable agreement depends 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 future payments that will be made to HFF Holdings will be $154.1 million, and has recorded this obligation to HFF Holdings as a liability on the consolidated balance sheet. In addition, during the year ended December 31, 2011, the tax rates used to measure the deferred tax assets were updated, which resulted in an increase of deferred tax assets of $4.8 million, which in turn resulted in an increase in the payable under the tax receivable agreement of $4.0 million. To the extent the Company does not realize all of the tax benefits in future years, this liability to HFF Holdings may be reduced.

In conjunction with the filing of the Company s 2010 federal and state tax returns, the benefit for 2010 relating to the Section 754 basis step-up was finalized resulting in $7.4 million tax benefits being realized by the Company for 2010. As discussed above, the Company is obligated to remit to HFF Holdings 85% of any such cash savings in federal and state tax. As such, during the third quarter of 2011 the Company paid $6.3 million to HFF Holdings under the tax receivable agreement. As of March 31, 2012, the Company has made payments to HFF Holdings pursuant to the terms of the tax receivable agreement in an aggregate amount of approximately $13.8 million and the Company anticipates to make a payment of $17.9 million to HFF Holdings in 2012.

13. Noncontrolling Interest

Noncontrolling 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 noncontrolling interest of $6.4 million was recorded representing HFF Holdings remaining interest in the Operating Partnerships following the initial public offering and the underwriters exercise of the overallotment option on February 21, 2007, along with HFF Holdings proportional share of net income earned by the Operating Partnerships subsequent to the change in ownership. As discussed in Note 1, HFF, Inc. is a holding company and, as such, does not generate income other than through its proportional share of net income earned by the Operating Partnerships. However, HFF, Inc. does incur certain costs which are not allocated or shared with the Operating Partnerships or their direct or indirect partners (including HFF Holdings) and, therefore, the net income as shown on the consolidated statements of income is not proportionately shared between the noncontrolling interest holder and the controlling interest holder.

As a result of the Reorganization Transactions, HFF Holdings beneficially owned 20,355,000 partnership units in each of the Operating Partnerships. Pursuant to the terms of HFF, Inc. s amended and restated certificate of incorporation, HFF Holdings can from time to time exchange its partnership units in the Operating Partnerships for shares of the Company s Class A common stock on the basis of two partnership units, one for each Operating Partnership, for one share of Class A common stock, subject to customary conversion rate adjustments for stock splits, stock dividends and reclassifications.

The table below sets forth the noncontrolling interest amount recorded for the three month periods ended March 31, 2012 and 2011, which includes the exchanges 845,947 and 1,113,691 partnership units in each of the Operating Partnerships by members of HFF Holdings for an equal amount of shares of Class A common stock during the three month periods ending March 31, 2012 and 2011, respectively. (dollars in thousands).

Three months ended March 31,