

**ORIGEN FINANCIAL, INC.**

Southfield, Michigan

CONSOLIDATED FINANCIAL STATEMENTS

Including Independent Auditors' Report

December 31, 2011 and 2010

# ORIGEN FINANCIAL, INC.

## TABLE OF CONTENTS

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<b>Independent Auditors' Report</b>	1
<b>Financial Statements</b>	
Consolidated Balance Sheets	2
Consolidated Statements of Operations	3
Consolidated Statements of Comprehensive Income (Loss)	4
Consolidated Statements of Changes in Stockholders' Equity	5
Consolidated Statements of Cash Flows	6
Notes to Consolidated Financial Statements	7 - 40



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## INDEPENDENT AUDITORS' REPORT

Stockholders and Board of Directors  
Origen Financial, Inc.  
Southfield, Michigan

We have audited the accompanying consolidated balance sheets of Origen Financial, Inc. as of December 31, 2011 and 2010 and the related consolidated statements of operations, comprehensive income (loss), changes in stockholders' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Origen Financial, Inc. as of December 31, 2011 and 2010 and the results of its operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Southfield, Michigan  
March 9, 2012

# ORIGEN FINANCIAL, INC.

## CONSOLIDATED BALANCE SHEETS (In thousands, except share data) December 31, 2011 and 2010

	2011	2010
<b>ASSETS</b>		
<b>ASSETS</b>		
Cash and cash equivalents	\$ 3,740	\$ 2,595
Restricted cash	9,767	9,981
Investments	1,707	1,996
Loans receivable, net	628,708	716,900
Furniture, fixtures and equipment, net	49	106
Repossessed houses, net	2,512	6,705
Other assets	5,149	5,818
<b>TOTAL ASSETS</b>	<b>\$ 651,632</b>	<b>\$ 744,101</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>LIABILITIES</b>		
Securitization financing	\$ 560,724	\$ 627,334
Derivative liabilities	41,662	37,090
Other liabilities	9,963	12,702
Total Liabilities	612,349	677,126
<b>STOCKHOLDERS' EQUITY</b>		
Preferred stock, \$.01 par value per share 10,000,000 shares authorized 125 shares issued and outstanding \$1,000 per share liquidation preference	125	125
Common stock, \$.01 par value per share 125,000,000 shares authorized 25,926,149 shares issued and outstanding	259	259
Additional paid in capital	225,230	225,542
Accumulated other comprehensive loss	(41,566)	(36,899)
Distributions in excess of earnings	(144,765)	(122,052)
Total Stockholders' Equity	39,283	66,975
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$ 651,632</b>	<b>\$ 744,101</b>

See accompanying notes to consolidated financial statements and independent auditors' report.

# ORIGEN FINANCIAL, INC.

## CONSOLIDATED STATEMENTS OF OPERATIONS (In thousands, except share data) Years Ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
<b>INTEREST INCOME</b>		
Interest income	\$ 63,435	\$ 71,641
Interest expense	<u>(41,849)</u>	<u>(48,029)</u>
Net Interest Income Before Loan Losses and Impairment	21,586	23,612
Provision for loan losses	24,079	26,606
Impairment of purchased loan pool	<u>-</u>	<u>382</u>
Net Interest Income (Loss) After Loan Losses and Impairment	<u>(2,493)</u>	<u>(3,376)</u>
<b>NON-INTEREST INCOME</b>		
Losses on Assets Held for Sale	-	(242)
Other	<u>3,659</u>	<u>3,002</u>
Total Non-Interest Income	<u>3,659</u>	<u>2,760</u>
<b>NON-INTEREST EXPENSE</b>		
Personnel	1,544	2,494
Loan origination and servicing	9,042	10,312
Investment impairment	-	26
State business taxes	217	167
Other operating	<u>2,118</u>	<u>2,971</u>
Total Non-Interest Expense	<u>12,921</u>	<u>15,970</u>
<b>Loss Before Income Taxes</b>	(11,755)	(16,586)
<b>INCOME TAX EXPENSE</b>	<u>53</u>	<u>8</u>
<b>NET LOSS</b>	<u>\$ (11,808)</u>	<u>\$ (16,594)</u>
Weighted average common shares outstanding, basic and diluted	<u>25,926,149</u>	<u>25,926,149</u>
NET LOSS – per common share, basic and fully diluted:	<u>\$ (0.46)</u>	<u>\$ (0.64)</u>

See accompanying notes to consolidated financial statements and independent auditors' report.

# ORIGEN FINANCIAL, INC.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(In thousands)

Years Ended December 31, 2011 and 2010

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	<u>2011</u>	<u>2010</u>
Net loss	\$ (11,808)	\$ (16,594)
Other comprehensive income (loss):		
Net unrealized gains (losses) on interest rate swaps, designated as cash cash flow hedges	(4,572)	(4,025)
Reclassification adjustment for net realized gains included in net loss	<u>(95)</u>	<u>(40)</u>
Total Other Comprehensive Income (Loss)	<u>(4,667)</u>	<u>(4,065)</u>
<b>COMPREHENSIVE INCOME (LOSS)</b>	<b><u>\$ (16,475)</u></b>	<b><u>\$ (20,659)</u></b>

See accompanying notes to consolidated financial statements and independent auditors' report.

## ORIGEN FINANCIAL, INC.

### CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY Years Ended December 31, 2011 and 2010 (In thousands, except share data)

	Preferred Stock	Common Stock	Additional Paid in Capital	Accumulated Other Comprehensive Income (Loss)	Distributions In Excess of Earnings	Total Stockholders' Equity
BALANCES, January 1, 2010	\$ 125	\$ 259	\$ 225,542	\$ (32,834)	\$ (102,850)	\$ 90,242
Net loss	-	-	-	-	(16,594)	(16,594)
Other comprehensive loss	-	-	-	(4,065)	-	(4,065)
Cash distribution paid (\$0.10 per common share)	-	-	-	-	(2,608)	-
	-	-	-	-	(2,608)	(2,608)
BALANCES, December 31, 2010	125	259	225,542	(36,899)	(122,052)	66,975
Net loss	-	-	-	-	(11,808)	(11,808)
Purchase and cancellation of warrants	-	-	(312)	-	-	(312)
Other comprehensive loss	-	-	-	(4,667)	-	(4,667)
Cash distribution paid (\$0.42 per common share)	-	-	-	-	(10,905)	-
	-	-	-	-	(10,905)	(10,905)
BALANCES, December 31, 2011	<u>\$ 125</u>	<u>\$ 259</u>	<u>\$ 225,230</u>	<u>\$ (41,566)</u>	<u>\$ (144,765)</u>	<u>\$ 39,283</u>

See accompanying notes to consolidated financial statements and independent auditors' report.

# ORIGEN FINANCIAL, INC.

## STATEMENTS OF CASH FLOWS Years Ended December 31, 2011 and 2010

	2011	2010
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net loss	\$ (11,808)	\$ (16,594)
Adjustments to reconcile to net cash flows from operating activities		
Provision for loan losses	24,079	26,606
Investment impairment	-	26
Impairment of purchased loan pool	-	382
Losses on assets held for sale	-	242
Depreciation and amortization	1,311	2,090
Decrease (increase) in other assets	2,656	(256)
(Decrease) increase in other liabilities	(2,740)	(1,009)
Net Cash Flows from Operating Activities	13,498	11,487
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Decrease in restricted cash	214	438
Proceeds from sale of investment securities	-	6,186
Principal collections on loans	51,871	51,801
Proceeds from sale of repossessed houses	13,473	13,904
Sale (expenditure) of capital assets	(3)	6
Net Cash Flows from Investing Activities	65,555	72,335
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Dividends paid	(10,905)	(2,608)
Proceeds from sale of 2004-B Class B-2 Notes	2,969	-
Repayment of securitization financing	(69,660)	(66,446)
Repayment of note payable - related party	-	(16,000)
Payment of warrant purchase - related party	(312)	-
Net Cash Flows from Financing Activities	(77,908)	(85,054)
<b>Net Change in Cash and Cash Equivalents</b>	1,145	(1,232)
<b>CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR</b>	2,595	3,827
<b>CASH AND CASH EQUIVALENTS - END OF YEAR</b>	3,740	2,595
<b>Supplemental cash flow disclosures</b>		
Cash paid for interest	\$ 41,189	\$ 47,120
Cash paid for income taxes	\$ 54	\$ 79
<b>Noncash investing activities</b>		
Loans transferred to repossessed assets	\$ 32,815	\$ 41,277
<b>Noncash operating activities</b>		
Decrease in value of derivative contracts	\$ 4,510	\$ 3,873

See accompanying notes to consolidated financial statements and independent auditors' report.

# ORIGEN FINANCIAL, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2011 and 2010

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### **NOTE 1 - Organization and Summary of Significant Accounting Policies**

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#### *Nature of Operations*

Origen Financial, Inc., a Delaware corporation (the "Company") is a real estate investment trust ("REIT"). Through March 2008 the Company's business was to originate, purchase and service manufactured housing loans. The Company's manufactured housing loans are amortizing loans that range in amounts from \$10,000 to \$250,000 and have terms of seven to thirty years and are located throughout the United States. The Company generally securitized or placed the manufactured housing loans it originated with institutional investors and retained the right to service the loans on behalf of those investors.

In March 2008, because of the lack of a reliable source for a loan warehouse facility and the unavailability of a profitable exit in the securitization market, the Company ceased originating loans for its own account and sold its portfolio of unsecuritized loans at a substantial loss. The proceeds from the loan sale were used to pay off its existing loan warehouse line of credit, which was not renewed.

In April 2008, the Company completed a secured financing transaction with a related party and used the proceeds, combined with other funds, to pay off the outstanding balance of a supplemental advance credit facility which would have expired in June 2008.

At the Company's annual stockholders meeting on June 25, 2008, the Company's stockholders approved an Asset Disposition and Management Plan. Pursuant to this plan, the company executed a number of transactions and took several actions, as follow:

- On June 30, 2008, the Company completed a transaction for the sale of its loan servicing platform assets and ceased all loan servicing operations.
- In July 2008, the Company completed the sale of certain assets of its loan origination and insurance business and used the proceeds to reduce its related party debt.

On January 14, 2009, the Company completed the sale of all the issued and outstanding stock of Origen Servicing, Inc ("Origen Servicing") to Prime RF Holdings LLC. The purchase price was \$175,000 and proceeds from the sale were used to reduce the Company's related party debt. Origen Servicing was a wholly owned subsidiary of the Company that prior to the sale of substantially all of Origen Servicing's assets to Green Tree in July 2008, conducted all of the Company's servicing operations.

Currently, most of the Company's activities are conducted through Origen Financial L.L.C., which is a wholly owned subsidiary. After the sale of the servicing and origination assets as described above, the Company's business essentially consists of actively managing its residual interests in its securitized loan portfolios.

# ORIGEN FINANCIAL, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2011 and 2010

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### **NOTE 1 - Organization and Summary of Significant Accounting Policies (cont.)**

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#### *Basis of Financial Statement Presentation*

These consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The accompanying consolidated financial statements include the financial position, results of operations and cash flows of the Company, its wholly owned qualified REIT and taxable REIT subsidiaries. All intercompany amounts have been eliminated.

#### *Use of Estimates in the Preparation of Financial Statements*

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Included in these financial statements are the following significant estimates: allowance for loan losses, valuation of repossessed homes, valuation of derivatives, and valuation of investments in loan pools and debt securities acquired with evidence of deterioration of credit quality. Actual results could materially differ from those estimates.

#### *Cash and Cash Equivalents*

Cash and cash equivalents represent short-term highly liquid investments with original maturities of three months or less and include cash and interest bearing deposits at banks. The Company has restricted cash related to securitized loans that are held in trust. The restricted cash represents principal and interest payments on manufactured housing loans that will be remitted to securitized trusts for distribution to bond holders. Cash balances may be in excess of amounts insured by the Federal Deposit Insurance Corporation.

#### *Investments*

All investments outstanding at December 31, 2011 are debt securities acquired with evidence of deterioration of credit quality since origination, and are accounted for as described below.

In 2009, the Company had additional securities that were accounted for under Accounting Standards Codification (ASC) Topic 320, "Investments - Debt and Equity Securities". These investments were classified as held-to-maturity. Investments classified as held-to-maturity were carried on the Company's balance sheet at amortized cost. All of the Company's held-to-maturity investments were sold in 2010.

All investments are regularly measured for impairment. Management uses its judgment to determine whether an investment has sustained an other-than-temporary decline in value. If management determines that an investment has sustained an other-than-temporary decline in its value, the investment is written down to its fair value by a charge to earnings, and a new cost basis is established for the investment. An evaluation of an other-than-temporary decline is dependent on the specific facts and circumstances. Factors considered in determining whether an other-than-temporary decline in value has occurred include: the estimated fair value of the investment in relation to its cost basis; the financial condition of the related entity; and the intent and ability to retain the investment for a sufficient period of time to allow for recovery in the fair value of the investment.

# ORIGEN FINANCIAL, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2011 and 2010

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### **NOTE 1 - Organization and Summary of Significant Accounting Policies (cont.)**

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#### *Loan Pools and Debt Securities Acquired with Evidence of Deterioration of Credit Quality*

The Company accounts for its investments in loan pools and debt securities acquired with evidence of deterioration of credit quality at the time of acquisition in accordance with ASC Topic 310, "Receivables, Loans, and Debt Securities Acquired with Deteriorated Credit Quality." The carrying values of such acquired loan pools and debt securities were approximately \$13.0 million and \$1.7 million, respectively, at December 31, 2011 and \$14.9 million and \$2.0 million, respectively, at December 31, 2010, and are included in loans receivable and investments, respectively, in the consolidated balance sheets.

Under the provisions of ASC Topic 310, each static pool of loans and debt securities is statistically modeled to determine its projected cash flows. The Company considers historical cash collections for loan pools and debt securities with similar characteristics as well as expected prepayments and estimates the amount and timing of undiscounted expected principal, interest and other cash flows for each pool of loans and debt securities. An internal rate of return is calculated for each static pool of loans and debt securities based on the projected cash flows and applied to the balance of the static pool. The resulting revenue recognized is based on the internal rate of return applied to the remaining balance of each static pool of loans and debt securities. Each static pool is analyzed at least quarterly to assess the actual performance compared to the expected performance. To the extent there are differences in actual performance versus expected performance, the internal rate of return is adjusted prospectively to reflect the revised estimate of cash flows over the remaining life of the static pool. Beginning January 2005, if revised cash flow estimates are less than the original estimates, ASC Topic 310 requires that the internal rate of return remain unchanged and an immediate impairment be recognized. For loans and debt securities acquired with evidence of deterioration of credit quality, if cash flow estimates increase subsequent to recording an impairment, ASC Topic 310 requires reversal of the previously recognized impairment before any increases to the internal rate of return are made. For any remaining increases in estimated future cash flows for loan pools or debt securities acquired with evidence of deterioration of credit quality, the Company adjusts the amount of accretable yield recognized on a prospective basis over the remaining life of the loan pool or debt security.

Application of the interest method of accounting requires the use of estimates to calculate a projected internal rate of return for each pool. These estimates are based on historical cash collections. If future cash collections are materially different in amount or timing than projected cash collections, earnings could be affected, either positively or negatively. Higher collection amounts or cash collections that occur sooner than projected will have a favorable impact on yields and revenues. Lower collection amounts or cash collections that occur later than projected will have an unfavorable impact and result in an immediate impairment being recognized.

#### *Loans Receivable*

Loans receivable consist of manufactured housing loans under contracts collateralized by the borrowers' manufactured houses and in some instances, related land. Generally, loans receivable are classified as held for investment and are carried at amortized cost, except for loans purchased with evidence of deterioration of credit quality since origination, which are accounted for as described above, under "Loan Pools and Debt Securities Acquired with Evidence of Deterioration of Credit Quality." Interest on loans is credited to income when earned. Loans held for investment include accrued interest and are presented net of deferred loan origination fees and costs and an allowance for estimated loan losses. All of the Company's loans receivable were classified as held for investment at December 31, 2011 and 2010.

# ORIGEN FINANCIAL, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2011 and 2010

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### **NOTE 1 - Organization and Summary of Significant Accounting Policies (cont.)**

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#### *Allowance for Loan Losses*

The allowance for possible loan losses is maintained at a level believed adequate by management to absorb losses on loans in the Company's loan portfolio. In accordance with ASC 805-20-25, "Pre-acquisition Contingencies" (formerly Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies"), the Company provides an allowance for loan losses when it is probable that a loan asset has been impaired and the amount of such loss can be reasonably estimated. The Company's loan portfolio is comprised of homogenous manufactured housing loans with average loan balances of approximately \$42,000 at December 31, 2011 and \$44,000 at December 31, 2010. The allowance for loan losses is developed at a portfolio level and the amount of the allowance is determined by establishing a calculated range of probable losses. A range of probable losses is calculated by applying historical loss rate factors to the loan portfolio on a stratified basis using the Company's current portfolio performance and delinquency levels (0-30 days, 31-60 days, 61-90 days and more than 90 days delinquent) and by the extrapolation of probable loan impairment based on the correlation of historical losses by vintage year of origination. The Company makes a determination of the best estimate within the calculated range of loan losses. Such determination may include, in addition to historical charge off experience, the impact of changed circumstances on current impairment of the loan portfolio. The accrual of interest is discontinued when a loan becomes more than 90 days past due. Cash receipts on impaired loans are applied first to accrued interest and then to principal. Impaired loans, or portions thereof, are charged off when deemed uncollectible. The allowance for loan losses represents an unallocated allowance. There are no elements of the allowance allocated to specific individual loans or to impaired loans.

#### *Furniture, Fixtures and Equipment*

Furniture, fixtures and equipment are stated at cost less accumulated depreciation. Depreciation is recognized on a straight-line basis over the estimated useful lives of the assets as follows:

Furniture and fixtures	7 years
Computers	5 years
Software	3 years
Leasehold improvements	Shorter of useful life or lease term

#### *Repossessed Houses*

Manufactured houses acquired through foreclosure or similar proceedings are recorded at the lesser of the related loan balance or the estimated fair value of the house.

#### *Other Assets*

Other assets are comprised of prepaid expenses, deferred financing costs and other miscellaneous receivables. Prepaid expenses are amortized over the expected service period. Deferred financing costs are capitalized and amortized over the life of the corresponding obligation.

# ORIGEN FINANCIAL, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2011 and 2010

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### **NOTE 1 - Organization and Summary of Significant Accounting Policies (cont.)**

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#### *Derivative Instruments and Hedging Activities*

Derivative instruments are carried at fair value on the consolidated balance sheets. The accounting for changes in the fair value (i.e., gains or losses) of a derivative instrument is determined by whether it has been designated and qualifies as part of a hedging relationship. For those derivative instruments that are designated and qualify as hedging instruments, the Company designates the hedging instrument, based upon the exposure being hedged. For derivative instruments that are designated and qualify as cash flow hedges (i.e., hedging the exposure to variability in expected future cash flows that is attributable to a particular risk), the effective portion of the gain or loss on the derivative instrument is reported as a component of other comprehensive income and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. The remaining gain or loss on the derivative instrument in excess of the cumulative change in the present value of future cash flows of the hedged item (i.e., the ineffective portion), if any, is recognized in current earnings during the period of change. For derivative instruments not designated as hedging instruments, the gain or loss is recognized in current earnings during the period of change.

For derivatives designated as hedging instruments at inception, the Company performs an analysis to assess effectiveness. Each derivative designated as a hedge has been and is expected to be highly effective in offsetting changes in cash flows of the hedged item. All components of each derivative instrument's gain or loss are included in the assessment of hedge effectiveness. Net hedge ineffectiveness is recorded in "interest expense" on the consolidated statements of income.

On January 1, 2009, the Company adopted new guidance relating to disclosures about derivative instruments and hedging activities. This new guidance requires entities to provide greater transparency about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for, and (c) how derivative instruments and related hedged items affect an entity's financial position, results of operations and cash flows. To meet those objectives, the guidance requires (1) qualitative disclosures about objectives for using derivatives by primary underlying risk exposure (e.g., interest rate, credit or foreign exchange rate) and by purpose or strategy (fair value hedge, cash flow hedge, net investment hedge and non-hedges), (2) information about the volume of derivative activity in a flexible format that the preparer believes is the most relevant and practicable, (3) tabular disclosures about balance sheet location and gross fair value amounts of derivative instruments, income statement and other comprehensive income location of gain and loss amounts on derivative instruments by type of contract, and (4) disclosures about credit-risk-related contingent features in derivative agreements. See footnote 8 for additional information.

#### *Securitizations Structured as Financings*

In prior years, the Company engaged in securitizations of its manufactured housing loan receivables. The Company structured all loan securitizations occurring since 2003 as financings for accounting purposes under ASC Topic 860, "Transfers and Servicing." When a loan securitization is structured as a financing, the financed asset remains on the Company's books along with the recorded liability that evidences the financing, typically bonds. Income from both the loan interest spread and the servicing fees received on the securitized loans are recorded into income by the loan servicer as earned. An allowance for credit losses is maintained on the loans. Deferred debt issuance costs and discount related to the bonds are amortized on a level yield basis over the estimated life of the bonds.

# ORIGEN FINANCIAL, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2011 and 2010

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### **NOTE 1 - Organization and Summary of Significant Accounting Policies (cont.)**

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#### *Share-Based Compensation*

The Company utilizes accounting guidance within ASC Topic 718, "Compensation-Stock Compensation," to account for its stock based compensation. This accounting guidance requires all share-based payments to employees, including grants of employee stock options, to be recognized as expense in the statement of operations based on their fair values. The amount of compensation is measured at the fair value of the options when granted and this cost is expensed over the required service period, which is normally the vesting period of the options. This accounting guidance applies to awards granted or modified after January 1, 2006 or any unvested awards outstanding prior to that date.

#### *Income Taxes*

The Company has elected to be taxed as a REIT as defined under Section 856(c)(1) of the Internal Revenue Code of 1986, as amended (the "Code"). In order for the Company to qualify as a REIT, at least ninety-five percent (95%) of the Company's gross income in any year must be derived from qualifying sources. In addition, a REIT must distribute at least ninety percent (90%) of its REIT taxable net income to its stockholders.

Qualification as a REIT involves the satisfaction of numerous requirements (some on an annual and quarterly basis) established under highly technical and complex Code provisions for which there are only limited judicial or administrative interpretations, and involves the determination of various factual matters and circumstances not entirely within the Company's control. In addition, frequent changes occur in the area of REIT taxation, which requires the Company continually to monitor its tax status.

As a REIT, the Company generally will not be subject to U.S. federal income taxes at the corporate level on the ordinary taxable income it distributes to its stockholders as dividends. If the Company fails to qualify as a REIT in any taxable year, its taxable income will be subject to U.S. federal income tax at regular corporate rates (including any applicable alternative minimum tax). Even if the Company qualifies as a REIT, it may be subject to certain state and local income taxes and to U.S. federal income and excise taxes on its undistributed taxable income. In addition, taxable income from non-REIT activities managed through taxable REIT subsidiaries, if any, is subject to federal and state income taxes. An income tax allocation is required to be estimated on the Company's taxable income generated by its taxable REIT subsidiaries. Deferred tax components arise based upon temporary differences between the book and tax basis of items such as the allowance for loan losses, accumulated depreciation, share based compensation and goodwill.

The provision for income taxes is based on amounts reported in the consolidated statements of operations and includes deferred income taxes on temporary differences between the income tax basis and financial accounting basis of assets and liabilities. Deferred tax assets are evaluated for realization based on available evidence of loss carry back capacity, future reversals of existing taxable temporary differences, and assumptions made regarding future events. A valuation allowance is provided when it is more-likely-than-not that some portion of the deferred tax asset will not be realized. The provision for income taxes assigned to discontinued operations is based on statutory rates, adjusted for permanent differences generated by those operations. There is a valuation allowance recorded to the extent of net deferred tax assets (primarily net operating losses) on the Company's taxable REIT subsidiaries. The amounts are not material to the financial statements.

The Company classifies interest and penalties on income tax liabilities in income tax expense on the consolidated statements of operations.

The provision (benefit) for income taxes is computed by applying the effective federal income tax rate to

# ORIGEN FINANCIAL, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2011 and 2010

### **NOTE 1 - Organization and Summary of Significant Accounting Policies (cont.)**

income (loss) before income taxes as reported in the consolidated financial statements after deducting non-taxable items, principally income from a qualified REIT subsidiary, then adding interest (tax related), penalties, and state taxes .

The Company does not believe that it has any uncertainty in its tax returns. Therefore, there are no accruals for interest, penalties or uncertain tax positions included in the Company's tax accrual. The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction and in various state and local jurisdictions. With few exceptions, the Company and its subsidiaries are no longer subject to U.S. federal or state and local income tax examinations by tax authorities for years before 2008.

For income tax purposes, distributions paid to common stockholders consist of ordinary income and return of capital. Distributions paid were taxable as follows for the years ended December 31 (dollars in thousands):

	2011		2010	
	Amount	Percentage	Amount	Percentage
Ordinary income	\$ -	-	\$ -	-
Return of capital	10,889	100.00	2,593	100.00
Total	<u>\$ 10,889</u>	<u>100.00</u>	<u>\$ 2,593</u>	<u>100.00</u>

A portion of the Company's income from a qualified REIT subsidiary that would otherwise be classified as a taxable mortgage pool may be treated as "excess inclusion income," which would be subject to the distribution requirements that apply to the Company and could therefore adversely affect its liquidity. Generally, a stockholder's share of excess inclusion income would not be allowed to be offset by any operating losses otherwise available to the stockholder. Tax exempt entities that own shares in a REIT must treat their allocable share of excess inclusion income as unrelated business taxable income. Any portion of a REIT dividend paid to foreign stockholders that is allocable to excess inclusion income will not be eligible for exemption from the 30% withholding tax (or reduced treaty rate) on dividend income. For the year ended December 31, 2011, 1.2% of distributions paid represented excess inclusion income.

# ORIGEN FINANCIAL, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2011 and 2010

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### **NOTE 1 - Organization and Summary of Significant Accounting Policies (cont.)**

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#### *Fair Value of Financial Instruments*

Fair values of financial instruments are based upon estimates at the balance sheet date of the price that would be received in an orderly transaction between market participants. The Company uses quoted market prices and observable inputs when available. However, these inputs are often not available in the markets for many of the Company's assets. In these cases management typically performs discounted cash flow analysis using its best estimates of key assumptions such as credit losses, prepayment speeds and discount rates based on both historical experience and its interpretation of how comparable market data in more active markets should be utilized. These estimates are subjective in nature and involve uncertainties and significant judgment in the interpretation of current market data. Therefore, the fair values presented may differ from amounts the Company could realize or settle currently.

#### *Recent Accounting Pronouncements*

In April 2011, the FASB issued ASU No. 2011-03, "Transfers and Servicing (Topic 860) – Reconsideration of Effective Control for Repurchase Agreements." Under the amended guidance, a transferor maintains effective control over transferred financial assets if there is an agreement that both entitles and obligates the transferor to repurchase the financial assets before maturity. In addition, the following requirements must be met: (a) the financial asset to be repurchased or redeemed are the same or substantially the same as those transferred, (b) the agreement is to repurchase or redeem the transferred financial asset before maturity at a fixed or determinable price, and (c) the agreement is entered into contemporaneously with, or in contemplation of the transfer. This guidance is effective prospectively for transactions, or modifications of existing transactions, that occur on or after the first interim or annual period beginning on or after December 15, 2011. The adoption of the guidance is not expected to have a material impact on the Company's Consolidated Financial Statements or the Notes thereto.

In May 2011, the FASB issued ASU No. 2011-04, "Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS." The amended guidance does not modify the requirements for when fair value measurements apply, rather it generally represents clarifications on how to measure and disclose fair value under Topic 820, Fair Value Measurement. Some of the amendments change the application of existing fair value measurement requirements and other amendments change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. ASU No. 2011-04 is intended to improve the comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with U.S. GAAP and International Financial Reporting Standards ("IFRS"), by ensuring that fair value has the same meaning in U.S. GAAP and IFRS and respective disclosure requirements are the same except for inconsequential differences in wording and style. This guidance is effective prospectively for annual and interim periods beginning after December 15, 2011. The adoption of the guidance is not expected to have a material impact on the Company's Consolidated Financial Statements or the Notes thereto.

In June 2011, the FASB issued ASU No. 2011-05, "Presentation of Comprehensive Income." The guidance is intended to improve the comparability of financial reporting and facilitate the convergence of U.S. GAAP and IFRS by amending the guidance in ASC 220, Comprehensive Income. Under the amended guidance, an entity has the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income ("OCI") either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, the entity is required to present on the face of the financial statements reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statement(s) where the components of net income and the components of other comprehensive income are presented. This guidance is effective retrospectively for annual and interim periods beginning after

# ORIGEN FINANCIAL, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2011 and 2010

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### **NOTE 1 - Organization and Summary of Significant Accounting Policies (cont.)**

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December 15, 2011 for certain requirements. On October 21, 2011, the FASB released a proposed deferral of the requirement that companies present reclassification adjustments for each component of OCI in both net income and OCI on the face of the financial statements. Early adoption is permitted. The adoption of the guidance is not expected to have a material impact on the Company's Consolidated Financial Statements or the Notes thereto.

In December 2011, the FASB issued ASU No. 2011-12, "Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05." The amendments to this guidance are effective at the same time as the amendments in ASU 2011-05, "Comprehensive Income (Topic 220) Presentation of Comprehensive Income," so that entities will not be required to comply with the presentation requirements in ASU 2011-05 that ASU 2011-12 is deferring. ASU 2011-12 supersedes certain pending paragraphs in ASU 2011-05 and are being made to allow the FASB time to redeliberate whether to present on the face of the financial statements the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income for all periods presented. This guidance is effective for annual and interim periods beginning on or after December 15, 2011. The adoption of the guidance is not expected to have a material impact on the Company's Consolidated Financial Statements or the Notes thereto.

#### *Reclassifications*

Certain amounts for prior periods have been reclassified to conform with current financial statement presentation.

# ORIGEN FINANCIAL, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2011 and 2010

### **NOTE 2 - Earnings Per Share**

Basic earnings per share is computed by dividing net loss by the weighted average number of common shares outstanding during the period. Diluted earnings per share incorporates the potential dilutive effect of common stock equivalents outstanding on an average basis during the period. Potential dilutive common shares primarily consist of employee stock options, non-vested common stock awards, stock purchase warrants and convertible notes. The following table presents a reconciliation of basic and diluted loss per share for the years ended December 31, 2011 and 2010 (in thousands, except share and per share data):

	<u>2011</u>	<u>2010</u>
Numerator:		
Net loss	\$ (11,808)	\$ (16,594)
Preferred stock dividends	(16)	(16)
Loss available to common shareholders, basic	<u>\$ (11,824)</u>	<u>\$ (16,610)</u>
Loss available to common shareholders, diluted	<u>\$ (11,824)</u>	<u>\$ (16,610)</u>
Denominator:		
Weighted average basic common shares outstanding	25,926,149	25,926,149
Effect of dilutive securities: Incremental share - non-vested stock awards	-	-
Weighted average diluted common shares outstanding	<u>25,926,149</u>	<u>25,926,149</u>
Net loss for common stockholders per share:		
Basic	<u>\$ (0.46)</u>	<u>\$ (0.64)</u>
Diluted	<u>\$ (0.46)</u>	<u>\$ (0.64)</u>

The weighted average anti-dilutive outstanding stock purchase warrants that were excluded from the computation of diluted loss per share for the years ended December 31, 2011 and 2010 were 0 and 2,600,000, respectively. The stock purchase warrants are considered anti-dilutive if assumed proceeds per share exceed the average market price of the Company's common stock during the relevant period or if the Company realized a net loss for the period. Assumed proceeds include proceeds from the exercise of the stock purchase warrants.

Anti-dilutive outstanding common stock options that were excluded from the computation of diluted loss per share for the years ended December 31, 2011 and 2010 were 135,500 and 135,500, respectively. The common stock options are considered anti-dilutive if assumed proceeds per share exceed the average market price of the Company's common stock during the relevant period or if the Company realized a net loss for the period. Assumed proceeds include proceeds from the exercise of the common stock options, as well as unearned compensation related to the common stock options.

# ORIGEN FINANCIAL, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2011 and 2010

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### NOTE 3 - Investments

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The Company follows the provisions of ASC Topics 320 and 310 in reporting its investments. The investments are carried on the Company's balance sheet at \$1.7 million and \$2.0 million at December 31, 2011 and 2010, respectively.

In 2009 the Company had investments that were accounted for under the provisions of ASC Topic 320 – "Investments Debt and Equity Securities" that were classified as held-to-maturity and reported at an amortized cost of \$6.4 million. In 2010 the investments were sold for \$6.2 million, which generated a realized loss of \$242,000. These securities were sold due to improved market conditions in order to enhance the liquidity of the Company.

As of December 31, 2011, all debt securities were debt securities acquired with evidence of deterioration of credit quality since origination and are accounted for under the provisions of ASC Topic 310. The carrying value of the debt securities accounted for under the provisions of ASC Topic 310 was approximately \$1.7 million and \$2.0 million at December 31, 2011 and 2010, respectively. See "Note 5 — Loan pools and Debt Securities Acquired with Evidence of Deterioration of Credit Quality" for further discussion related to the Company's debt securities accounted for under the provisions of ASC Topic 310.

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### NOTE 4 - Loans Receivable

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The carrying amounts and fair value of loans receivable consisted of the following at December 31 (in thousands):

	2011	2010
Manufactured housing loans - securitized	\$ 645,610	\$ 735,192
Manufactured housing loans - unsecuritized	1,491	1,923
Accrued interest receivable	4,503	5,005
Deferred loan origination costs	1,756	2,280
Discount on originated loans (1)	(12,610)	(14,364)
Discount on purchased loans	(632)	(1,009)
Allowance for purchased loans	(2,689)	(2,689)
Allowance for loan losses	(8,721)	(9,438)
Total	<u>\$ 628,708</u>	<u>\$ 716,900</u>

(1) Represents the fair market value of servicing rights sold in July 2008 which are related to loans held-for-investment. The discount is accreted into interest income over the life of the loans on a level yield method.

The following table sets forth the average per loan balance, weighted average loan yield, and weighted average initial term at December 31 (dollars in thousands):

	2011	2010
Number of loans receivable	15,301	16,721
Average loan balance	\$ 42	\$ 44
Weighted average loan yield	9.36%	9.38%
Weighted average initial term	20 years	20 years

## ORIGEN FINANCIAL, INC.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2011 and 2010

#### **NOTE 4 - Loans Receivable (cont.)**

The following table sets forth the concentration by state of the manufactured housing loan portfolio at December 31 (dollars in thousands):

	2011		2010	
	Principal	Percent	Principal	Percent
California	\$ 263,850	40.8	\$ 301,722	40.9
Texas	52,801	8.1	60,285	8.2
New York	32,804	5.1	36,823	5.0
Florida	21,855	3.4	24,910	3.4
Alabama	20,620	3.2	22,800	3.1
Other	255,171	39.4	290,575	39.4
Total	\$ 647,101	100.0	\$ 737,115	100.0

The following table sets forth the number and value of loans for various original terms for the manufactured housing loan portfolio at December 31 (dollars in thousands):

Original Term in Years	2011		2010	
	Number of Loans	Principal Balance	Number of Loans	Principal Balance
5 or less	34	\$ 1,610	36	\$ 1,650
6-10	926	9,478	1,112	13,782
11-12	113	1,860	132	2,460
13-15	3,775	85,523	4,186	102,831
16-20	8,384	417,974	9,027	472,231
21-25	848	43,520	918	48,720
26-30	1,221	87,136	1,310	95,441
Total	15,301	\$ 647,101	16,721	\$ 737,115

Delinquency statistics for the manufactured housing loan portfolio are as follows at December 31 (dollars in thousands):

Days Delinquent	2011			2010		
	Number of Loans	Principal Balance	% of Portfolio	Number of Loans	Principal Balance	% of Portfolio
31-60	163	\$ 6,688	1.0	144	\$ 5,427	0.7
61-90	48	2,087	0.3	58	2,436	0.3
Greater than 90	114	6,017	0.9	142	7,179	1.0

The Company defines non-performing loans as those loans that are greater than 90 days delinquent in contractual principal payments. The average balance of all non-performing loans as a group was \$5.8 million and \$7.3 million for the years ended December 31, 2011 and 2010, respectively.

# ORIGEN FINANCIAL, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2011 and 2010

### **NOTE 5 - Loan Pools and Debt Securities Acquired with Evidence of Deterioration of Credit Quality**

The Company has loan pools and debt securities that were acquired, for which there was at acquisition, evidence of deterioration of credit quality, and for which it was probable, at acquisition, that all contractually required payments would not be collected. These loan pools and debt securities are accounted for under the provisions of ASC Topic 310.

#### *Loan Pools Acquired with Evidence of Deterioration of Credit Quality*

The carrying amount of loan pools acquired with evidence of deterioration of credit quality was as follows at December 31 (in thousands):

	2011	2010
Outstanding balance	<u>\$ 15,424</u>	<u>\$ 17,671</u>
Carrying amount, net of allowance of \$2,689 and \$2,689, respectively	<u>\$ 13,006</u>	<u>\$ 14,879</u>

Accretable yield represents the excess of expected future cash flows over the remaining carrying value of the purchased portfolio, which is recognized as interest income on a level yield basis over the life of the loan portfolio. Nonaccretable yield represents the difference between the remaining expected cash flows and the total contractual obligation outstanding of the purchased receivables. Changes in accretable yield for the years ended December 31 were as follows (in thousands):

	2011	2010
Beginning balance	\$ 8,538	\$ 9,769
Accretion	<u>(970)</u>	<u>(1,231)</u>
Ending balance	<u>\$ 7,568</u>	<u>\$ 8,538</u>

During the years ended December 31, 2011 and 2010, the Company increased the allowance by charges to the income statement of approximately \$0 and \$382,000, respectively. No allowances were reversed during the years ended December 31, 2011 and 2010.

During the years ended December 31, 2011 and 2010, there were no loans acquired for which it was probable at acquisition that all contractually required payments would not be collected.

# ORIGEN FINANCIAL, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2011 and 2010

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### **NOTE 5 - Loan Pools and Debt Securities Acquired with Evidence of Deterioration of Credit Quality (cont.)**

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#### *Debt Securities Acquired with Evidence of Deterioration of Credit Quality*

The carrying amount of debt securities acquired with evidence of deterioration of credit quality was as follows at December 31 (in thousands):

	<u>2011</u>	<u>2010</u>
Outstanding balance	\$ 8,603	\$ 8,610
Carrying amount, net	\$ 1,707	\$ 1,996

Accretable yield represents the excess of expected future cash flows over the remaining carrying value of the debt securities, which is recognized as interest income on a level yield basis over the life of the debt securities. Nonaccretable difference represents the difference between the remaining expected cash flows and the total contractual obligation outstanding of the debt securities. Changes in accretable yield for the years ended December 31 were as follows (in thousands):

	<u>2011</u>	<u>2010</u>
Beginning balance	\$ 2,212	\$ 3,007
Accretion	(333)	(386)
Change in estimate of future cash flows	<u>816</u>	<u>(409)</u>
Ending balance	<u>\$ 2,695</u>	<u>\$ 2,212</u>

During the years ended December 31, 2011 and 2010 the Company recognized an other-than-temporary impairment of approximately \$0 and \$26,000, respectively on the principal balance of the security.

During the years ended December 31, 2011 and 2010, there were no debt securities acquired for which it was probable at acquisition that all contractually required payments would not be collected.

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### **NOTE 6 - Allowance for Loan Losses**

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The allowance for loan losses and related additions and deductions to the allowance for the years ended December 31 were as follows (in thousands):

	<u>2011</u>	<u>2010</u>
Balance at beginning of period	\$ 22,312	\$ 21,523
Provision for loan losses	24,079	26,606
Gross charge offs	(40,311)	(35,130)
Recoveries	<u>9,008</u>	<u>9,313</u>
Balance at end of period	<u>\$ 15,088</u>	<u>\$ 22,312</u>
Allocation to carrying value of repossessed houses	<u>(6,367)</u>	<u>(12,874)</u>
Net Allowance	<u>\$ 8,721</u>	<u>\$ 9,438</u>

# ORIGEN FINANCIAL, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2011 and 2010

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### NOTE 7 - Property and Equipment

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Furniture, fixtures and equipment are summarized as follows at December 31 (in thousands):

	2011	2010
Furniture and fixtures	\$ 355	\$ 390
Leasehold improvements	203	203
Computer equipment	184	364
Capitalized software	130	130
Total	872	1,087
Less: accumulated depreciation	(823)	(981)
Net Property and Equipment	<u>\$ 49</u>	<u>\$ 106</u>

Depreciation expense was approximately \$60,000 and \$85,000, for the years ended December 31, 2011 and 2010, respectively.

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### NOTE 8 - Derivatives

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In the normal course of business, the Company enters into various transactions involving derivatives to manage exposure to fluctuations in interest rates. These financial instruments involve, to varying degrees, elements of credit and market risk.

Credit risk is the possible loss that may occur in the event of nonperformance by the counterparty to a financial instrument. The Company attempts to minimize credit risk arising from financial instruments by evaluating the creditworthiness of each counterparty, adhering to the same credit approval process used for traditional lending activities. Counterparty risk limits and monitoring procedures also facilitate the management of credit risk. The Company generally does not receive collateral when it enters into a derivative contract.

Market risk is the potential loss that may result from movements in interest rates that cause an unfavorable change in the value of a financial instrument. Market risk arising from derivative instruments is reflected in the consolidated financial statements. The Company manages this risk by establishing monetary exposure limits and monitoring compliance with those limits. Market risk inherent in derivative instruments held or issued for risk management purposes is typically offset by changes in the fair value of the assets or liabilities being hedged.

When hedge accounting is discontinued because the Company determines that the derivative no longer qualifies as a hedge, the derivative will continue to be recorded on the consolidated balance sheet at its fair value. Any change in the fair value of a derivative no longer qualifying as a hedge is recognized in current period earnings. For terminated cash flow hedges or cash flow hedges that no longer qualify as highly effective, the effective position previously recorded in accumulated other comprehensive income is recorded in earnings when the hedged item affects earnings.

# ORIGEN FINANCIAL, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2011 and 2010

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### **NOTE 8 – Derivatives (cont.)**

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#### *Derivative Instruments*

Derivative instruments are traded over an organized exchange or negotiated over-the-counter. Credit risk associated with exchange traded contracts is typically assumed by the organized exchange. Over-the-counter contracts are tailored to meet the needs of the counterparties involved and, therefore, contain a greater degree of credit risk and liquidity risk than exchange traded contracts, which have standardized terms and readily available price information. The Company reduces exposure to credit and liquidity risks from over-the-counter derivative instruments entered into for risk management purposes, by conducting such transactions with investment grade domestic financial institutions and subjecting counterparties to credit approvals, limits and monitoring procedures similar to those used in making other extensions of credit.

Detailed discussions of each class of derivative instruments held or issued by the Company for both risk management are as follows.

#### *Interest Rate Swaps*

Interest rate swaps are agreements in which two parties periodically exchange fixed cash payments for variable payments based on a designated market rate or index, or variable payments based on two different rates or indices, applied to a specified notional amount until a stated maturity. The Company's swap agreements are structured such that variable payments are primarily based on one month LIBOR or three-month LIBOR. These instruments are principally negotiated over-the-counter and are subject to credit risk, market risk and liquidity risk. All interest rate swaps entered into by the Company were entered with the intent to offset potential increases in interest expense and potential variability in cash flows under various interest rate environments. The Company does not speculate on interest rates. All interest rate swaps were entered into for the purpose of hedging the Company's exposure to interest rate risk. When it is determined that a derivative is not highly effective as a hedge or that it has ceased to be a highly effective hedge the Company discontinues hedge accounting and all changes in value in the derivative instrument are recorded in interest expense in the income statement.

Documents governing interest rate swap agreements contain certain restrictive covenants. One of the Company's interest rate swap agreements contains a minimum net worth covenant that the Company does not meet. This entitles the counterparty to initiate an early termination of the interest rate swap agreement. As of December 31, 2011, based upon the termination value of the Company's position in the interest rate swap agreement, such early termination would result in monies due to the Company.

# ORIGEN FINANCIAL, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2011 and 2010

### **NOTE 8 – Derivatives (cont.)**

The following table presents the composition of the Company's derivative instruments at December 31, 2011 and 2010 (in thousands):

	December 31, 2011		
	Notional/ Contract Amount	Fair Value	
		Asset Derivatives (Unrealized Gains)	Liability Derivatives (Unrealized Losses)
<b>Derivatives designated as hedging instruments:</b>			
Interest rate contracts: Swaps - cash flow - receive floating/pay fixed	\$ 315,605	\$ -	\$ 41,662
<b>Derivatives not designated as hedging instruments:</b>			
Interest rate contracts: Swaps - cash flow - receive floating/pay fixed	251,453	472	-
Total Derivatives	<u>\$ 567,058</u>	<u>\$ 472</u>	<u>\$ 41,662</u>
	December 31, 2010		
	Notional/ Contract Amount	Fair Value	
		Asset Derivatives (Unrealized Gains)	Liability Derivatives (Unrealized Losses)
<b>Derivatives designated as hedging instruments:</b>			
Interest rate contracts: Swaps - cash flow - receive floating/pay fixed	\$ 349,108	\$ -	\$ 37,090
<b>Derivatives not designated as hedging instruments:</b>			
Interest rate contracts: Swaps - cash flow - receive floating/pay fixed	296,610	409	-
Total Derivatives	<u>\$ 645,718</u>	<u>\$ 409</u>	<u>\$ 37,090</u>

# ORIGEN FINANCIAL, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2011 and 2010

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### **NOTE 8 – Derivatives (cont.)**

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By entering into derivative contracts, the Company is exposed to credit risk if the counterparties fail to perform. The Company minimizes credit risk through credit approvals, limits, monitoring procedures and collateral requirements. Nonperformance risk, including credit risk, is included in the determination of net fair value.

At December 31, 2011, master netting arrangements were in place with all interest rate swap counterparties. These arrangements effectively reduce credit risk by permitting settlement, on a net basis, of contracts entered into with the same counterparty.

As part of a cash flow hedging strategy, the Company entered into interest rate swap agreements (weighted average original maturity of 5.24 years) that effectively converts a portion of existing floating rate debt to a fixed rate basis, thus reducing the impact of interest rate changes on future interest expense over the life of the agreements.

If interest rates, interest yield curves and notional amounts remain consistent with current projections, the Company expects to reclassify \$11.6 million of comprehensive loss, net of tax, to interest expense on derivative instruments designated as cash flow hedges during the next twelve months due to receipt of variable interest associated with floating rate debt.

# ORIGEN FINANCIAL, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2011 and 2010

### **NOTE 8 – Derivatives (cont.)**

The following table summarizes the expected weighted average remaining maturity of the notional amount of interest rate swaps and the weighted average interest rates associated with amounts expected to be received or paid on interest rate swap agreements as of December 31, 2011 and 2010 (in thousands).

		December 31, 2011	
		Fair Value	
Notional/ Contract Amount	Asset Derivatives (Unrealized Gains)	Liability Derivatives (Unrealized Losses)	
<b>Interest rate contracts:</b>			
Swaps - cash flow - receive floating/pay fixed rate - Designated as hedging instruments	\$ 315,605	-	5.28%
<b>Interest rate contracts:</b>			
Swaps - cash flow - receive floating/pay fixed rate - Not Designated as hedging instruments	251,453	0.28%	-
Total	\$ 567,058	0.28%	5.28%
		December 31, 2010	
		Fair Value	
Notional/ Contract Amount	Asset Derivatives (Unrealized Gains)	Liability Derivatives (Unrealized Losses)	
<b>Interest rate contracts:</b>			
Swaps - cash flow - receive floating/pay fixed rate - Designated as hedging instruments	\$ 349,108	-	5.28%
<b>Interest rate contracts:</b>			
Swaps - cash flow - receive floating/pay fixed rate - Not Designated as hedging instruments	296,610	0.26%	-
Total	\$ 645,718	0.26%	5.28%

Management believes these hedging strategies achieve the desired relationship between the fixed cash flow requirements of the derivative contracts and the variable cash flow requirements of its securitization financing which, in turn, reduce the overall exposure of net interest expense to interest rate risk, although there can be no assurance that such strategies will be successful.

# ORIGEN FINANCIAL, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2011 and 2010

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### **NOTE 9 - Loan Securitizations**

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Historically the Company securitized manufactured housing loans. The Company recorded each transaction based on its legal structure. Under the legal structure of the current securitizations, the Company exchanged manufactured housing loans it originated and purchased with a trust for cash. The trust then issued ownership interests to investors in asset backed bonds secured by the loans.

The Company structured all loan securitizations occurring since 2003 as financings for accounting purposes. When securitizations are structured as financings no gain or loss is recognized, nor is any allocation made to residual interests or servicing rights. Rather, the loans securitized continue to be carried by the Company as assets, and the asset backed bonds secured by the loans are carried as a liability. The Company records interest income on securitized loans and interest expense on the bonds issued in the securitizations over the life of the securitizations. Deferred debt issuance costs and discount related to the bonds are amortized on a level yield basis over the estimated life of the bonds.

Prior to 2003, the Company sold loan pools that were treated as true sales in accordance with the accounting guidance within ASC Topic 860, "Transfers and Servicing."

Whenever the Company sells loans, it makes customary representations and warranties to purchasers about various characteristics of each loan, such as the manner of origination, the nature and extent of underwriting standards applied, and the types of documentation being provided. Typically these representations and warranties are in place for the life of the loan. If a loan does not perform, and a defect in the origination process is identified, the Company may be required to either repurchase the loan or indemnify the purchaser for losses it may incur on such loan. To date, the Company has not experienced any claims on its representations and warranties for loan pool sales that were accounted for as true sales. The Company has an insurance contract in place against losses in excess of \$250,000 relating to representation and warranty claims. The Company does not believe that it has any exposure to representation and warranty claims; therefore it has not created an accrual for potential claims.

Loan securitization transactions are subject to certain restrictive covenants as detailed in the governing transaction documents. The Company monitors compliance with these covenants on a continuing basis.

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### **NOTE 10 - Debt**

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Total debt outstanding was as follows at December 31 (in thousands):

	<u>2011</u>	<u>2010</u>
Securitization financing	<u>\$ 560,724</u>	<u>\$ 627,334</u>

# ORIGEN FINANCIAL, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2011 and 2010

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### **NOTE 10 – Debt (cont.)**

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#### *Securitization Financing — 2004-A Securitization*

On February 11, 2004, the Company completed a securitization of approximately \$238.0 million in principal balance of manufactured housing loans. The securitization was accounted for as a financing. As part of the securitization the Company, through a special purpose entity, issued \$200.0 million in notes payable. The notes are stratified into six different classes and pay interest at a duration weighted average rate of approximately 5.12%. The notes have a contractual maturity date of October 2013 with respect to the Class A-1 notes; August 2017, with respect to the Class A-2 notes; December 2020, with respect to the Class A-3 notes; and January 2035, with respect to the Class A-4, Class M-1 and Class M-2 notes. The outstanding balance on the 2004-A securitization notes was approximately \$57.2 million and \$66.0 million at December 31, 2011 and 2010, respectively.

#### *Securitization Financing — 2004-B Securitization*

On September 29, 2004, the Company completed a securitization of approximately \$200.0 million in principal balance of manufactured housing loans. The securitization was accounted for as a financing. As part of the securitization the Company, through a special purpose entity, issued \$169.0 million in notes payable. The notes are stratified into seven different classes and pay interest at a duration-weighted average rate of approximately 5.27%. The notes have a contractual maturity date of June 2013 with respect to the Class A-1 notes; December 2017, with respect to the Class A-2 notes; August 2021, with respect to the Class A-3 notes; and November 2035, with respect to the Class A-4, Class M-1, Class M-2 and Class B-1 notes. The outstanding balance on the 2004-B securitization notes was approximately \$57.8 million and \$62.8 million at December 31, 2011 and 2010, respectively. Prior to March 25, 2011, the Company owned \$3.0 million of the 2004-B securitization notes. Accordingly, this amount was treated as unissued debt and netted against securitized financing. On March 25, 2011, the Company sold its ownership of the Class B-2 notes, resulting in an increase of \$3.0 million of outstanding balance on the 2004-B securitization notes.

#### *Securitization Financing — 2005-A Securitization*

On May 12, 2005, the Company completed a securitization of approximately \$190.0 million in principal balance of manufactured housing loans. The securitization was accounted for as a financing. As part of the securitization the Company, through a special purpose entity, issued \$165.3 million in notes payable. The notes are stratified into seven different classes and pay interest at a duration-weighted average rate of approximately 5.30%. The notes have a contractual maturity date of July 2013 with respect to the Class A-1 notes; May 2018, with respect to the Class A-2 notes; October 2021, with respect to the Class A-3 notes; and June 2036, with respect to the Class A-4, Class M-1, Class M-2 and Class B notes. The outstanding balance on the 2005-A securitization notes was approximately \$63.2 million and \$72.1 million at December 31, 2011 and 2010, respectively.

#### *Securitization Financing — 2005-B Securitization*

On December 15, 2005, the Company completed a securitization of approximately \$175.0 million in principal balance of manufactured housing loans. The securitization was accounted for as a financing. As part of the securitization the Company, through a special purpose entity, issued \$156.2 million in notes payable. The notes are stratified into eight different classes and pay interest at a duration-weighted average rate of approximately 6.15%. The notes have a contractual maturity date of February 2014 with respect to the Class A-1 notes; December 2018, with respect to the Class A-2 notes; May 2022, with respect to the Class A-3 notes; and January 2037, with respect to the Class A-4, Class M-1, Class M-2,

# ORIGEN FINANCIAL, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2011 and 2010

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### **NOTE 10 – Debt (cont.)**

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Class B-1 and B-2 notes. The outstanding balance on the 2005-B securitization notes was approximately \$69.3 million and \$79.7 million at December 31, 2011 and 2010, respectively.

#### *Securitization Financing — 2006-A Securitization*

On August 25, 2006, the Company completed a securitization of approximately \$224.2 million in principal balance of manufactured housing loans. The securitization was accounted for as a financing. As part of the securitization the Company, through a special purpose entity, issued \$200.6 million in notes payable. The notes are stratified into two different classes. The Class A-1 notes pay interest at one month LIBOR plus 15 basis points and have a contractual maturity date of November 15, 2018. The Class A-2 notes pay interest based on a rate established by the auction agent at each rate determination date and have a contractual maturity date of October 2037. Additional credit enhancement was provided through the issuance of a financial guaranty insurance policy by Ambac Assurance Corporation. The outstanding balance on the 2006-A securitization notes was approximately \$110.0 million and \$122.2 at December 31, 2011 and 2010, respectively.

#### *Securitization Financing — 2007-A Securitization*

On May 2, 2007, the Company completed a securitization of approximately \$200.4 million in principal balance of manufactured housing loans. The securitization was accounted for as a financing. As part of the securitization the Company, through a special purpose entity, issued \$184.4 million in notes payable. The notes are stratified into two different classes. The Class A-1 notes pay interest at one month LIBOR plus 19 basis points and have a contractual maturity date of April 2037. The Class A-2 notes pay interest based on a rate established by the auction agent at each rate determination date and have a contractual maturity date of April 2037. Additional credit enhancement was provided through the issuance of a financial guaranty insurance policy by Ambac Assurance Corporation. The outstanding balance on the 2007-A securitization notes was approximately \$116.6 million and \$128.5 at December 31, 2011 and 2010, respectively.

#### *Securitization Financing — 2007-B Securitization*

On October 16, 2007, the Company completed a securitization of approximately \$140.0 million in principal balance of manufactured housing loans. The securitization was accounted for as a financing. As part of the securitization the Company, through a special purpose entity, issued \$126.7 million of a single AAA rated floating rate class of asset backed notes to a single qualified institutional buyer pursuant to Rule 144A under the Securities Act of 1933. The notes pay interest at one month LIBOR plus 120 basis points and have a contractual maturity date of September 2037. Additional credit enhancement was provided by a guaranty from Ambac Assurance Corporation. The outstanding balance on the 2007-B securitization notes was approximately \$86.5 million and \$96.0 at December 31, 2011 and 2010, respectively.

# ORIGEN FINANCIAL, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2011 and 2010

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### NOTE 10 - Debt (cont.)

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The average balance and average interest rate of outstanding debt was as follows at December 31 (dollars in thousands):

	2011		2010	
	Average Balance	Average Rate	Average Balance	Average Rate
Securitization financing — 2004-A securitization	62,146	6.1	70,235	6.1
Securitization financing — 2004-B securitization	61,390	6.1	67,544	6.1
Securitization financing — 2005-A securitization	68,082	5.8	76,845	5.7
Securitization financing — 2005-B securitization	75,073	6.2	85,192	6.1
Securitization financing — 2006-A securitization	116,211	8.3	128,276	8.4
Securitization financing — 2007-A securitization	123,166	7.8	134,165	7.9
Securitization financing — 2007-B securitization	91,312	7.0	100,243	7.0

At December 31, 2011, the total of maturities and amortization of debt during the next five years and thereafter are approximately as follows: 2012 — \$61.6 million; 2013 — \$53.3 million; 2014 — \$48.9 million; 2015 — \$77.6 million; 2016 — \$63.9 million and \$255.7 million thereafter.

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### NOTE 11 - Employee Benefits

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The Company maintains a 401(k) plan covering all employees who meet certain minimum requirements. Participating employees can make salary contributions to the plan up to Internal Revenue Code limits. The Company matches \$1.00 for each dollar contributed by each eligible participant in the plan up to the first 1% of each eligible participant's annual compensation and \$0.50 for each dollar contributed by each eligible participant in the plan up to the next 5% of each eligible participant's annual compensation. The Company's related expense was approximately \$35,000 and \$33,000, respectively for the years ended December 31, 2011 and 2010.

# ORIGEN FINANCIAL, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2011 and 2010

### **NOTE 12 - Share Based Compensation Plan**

The Company's equity incentive plan has approximately 1.8 million shares of common stock reserved for issuance as either stock options or non-vested stock grants. As of December 31, 2011, approximately 373,302 shares of common stock remained available for issuance, as either stock options or non-vested stock grants, under the plan. No compensation cost has been charged against income for those plans for the years ended December 31, 2011 and 2010.

#### *Stock Options*

Under the plan, the exercise price of the options will not be less than the fair market value of the common stock on the date of grant. The date on which the options are first exercisable is determined by the Compensation Committee of the Board of Directors as the administrator of the Company's equity incentive plan, and options that have been issued to date generally vested over a two-year period, have 10-year contractual terms and a 5-year expected option term. The Company does not pay dividends or make distributions on unexercised options. As of December 31, 2011 there was no unrecognized compensation cost related to stock options granted under the equity incentive plan.

There were no stock options granted during the years ended December 31, 2011 or 2010. No stock options were exercised during the years ended December 31, 2011 and 2010. The following table summarizes the activity relating to the Company's stock options for the year ended December 31, 2011:

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term
Options outstanding at January 1, 2011	135,500	\$ 10.00	2.0
Granted	-	-	-
Exercised	-	-	-
Forfeited	-	-	-
Options outstanding at December 31, 2011	<u>135,500</u>	<u>\$ 10.00</u>	<u>2.0</u>
Options exercisable at December 31, 2011	<u>135,500</u>	<u>\$ 10.00</u>	<u>2.0</u>

#### *Non-Vested Stock Awards*

The Company grants non-vested stock awards to certain directors, officers and employees under the equity incentive plan. The grantees of the non-vested stock awards are entitled to receive all dividends and other distributions paid with respect to the common shares of the Company underlying such non-vested stock awards at the time such dividends or distributions are paid to holders of common shares.

The Company recognizes compensation expense for outstanding non-vested stock awards over their vesting periods for an amount equal to the fair value of the non-vested stock awards at grant date. As of December 31, 2011 there was no unrecognized compensation cost related to non-vested stock awards granted under the equity incentive plan. On July 1, 2008 as a result of the sale of the Company's servicing platform assets to Green Tree, all non-vested stock awards granted under the equity incentive plan vested and total unrecognized compensation expense was recognized at that time.

# ORIGEN FINANCIAL, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2011 and 2010

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### **NOTE 13 - Stockholders' Equity**

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Effective January 1, 2004, the Company sold 125 shares of its Series A Cumulative Redeemable Preferred Stock directly to 125 investors at a per share price of \$1,000. The transaction resulted in net proceeds to the Company of \$95,000. These shares pay dividends quarterly at an annual rate of 12.5%.

On October 8, 2003, the Company completed a private placement of \$150.0 million of its common stock to certain institutional and accredited investors.

On February 4, 2004, the Company completed a private placement of 1,000,000 shares of its common stock to one institutional investor. The offering provided net proceeds to the Company of approximately \$9.4 million.

On May 6, 2004, the Company completed an initial public offering of 8.0 million shares of its common stock. In June 2004 the underwriters of the initial public offering purchased an additional 625,900 shares of the Company's common stock pursuant to an underwriter's over-allotment option. Net proceeds from these transactions were \$72.2 million after discount and expenses.

In September 2005, the Securities and Exchange Commission declared effective the Company's shelf registration statement on Form S-3 for the proposed offering, from time to time, of up to \$200 million of its common stock, preferred stock and debt securities. In addition to such debt securities, preferred stock and common stock the Company could sell under the registration statement from time to time, the Company registered for sale 1,540,000 shares of its common stock pursuant to a sales agreement entered into with Brinson Patrick Securities Corporation. Sales under the agreement commenced on June 5, 2007. There were no sales under this agreement during the years ended December 31, 2011 and 2010. The Company sold 50,063 shares of common stock under the sales agreement with Brinson Patrick Securities Corporation during the year ended December 31, 2007, at the price of the Company's common stock prevailing at the time of each sale. The Company received proceeds, net of commissions, of \$296,000 during the year ended December 31, 2007, as a result of these sales.

In conjunction with a \$46 million secured note lending arrangement on April 8, 2008, with a related party, a five year stock purchase warrant for 2,600,000 shares of the Company's common stock was issued to the related party at an exercise price of \$1.22 per share. The secured note was paid off entirely in October 2010 and the Company paid the related party \$312,000 or \$0.12 per share to purchase and cancel the warrant.

# ORIGEN FINANCIAL, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2011 and 2010

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### **NOTE 13 - Stockholders' Equity (cont.)**

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In December 2008, the Company voluntarily delisted its common stock from the NASDAQ Global Market, deregistered its common stock under the Securities Act of 1934 and terminated its shelf registration statement on Form S-3 and its registration statement on Form S-8.

Data pertaining to the Company's distributions declared and paid to common stockholders during the years ended December 31, 2011 and 2010 are as follows:

<u>Declaration Date</u>	<u>Record Date</u>	<u>Date Paid</u>	<u>Distribution per Share</u>	<u>Total Distribution (thousands)</u>
November 17, 2011	November 30, 2011	December 7, 2011	\$ 0.09	\$ 2,333
August 18, 2011	September 2, 2011	September 13, 2011	\$ 0.09	\$ 2,333
May 26, 2011	June 13, 2011	June 22, 2011	\$ 0.17	\$ 4,408
March 29, 2011	April 11, 2011	April 21, 2011	\$ 0.07	\$ 1,815
November 2, 2010	November 30, 2010	December 21, 2010	\$ 0.10	\$ 2,592

# ORIGEN FINANCIAL, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2011 and 2010

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### **NOTE 14 - Liquidity Risks and Uncertainties**

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The risks associated with the Company's business become more acute in any economic slowdown or recession. Periods of economic slowdown or recession may be accompanied by decreased demand for consumer credit and declining asset values. In the manufactured housing business, any material decline in collateral values increases the loan-to-value ratios of loans previously made, thereby weakening collateral coverage and increasing the size of losses in the event of default. Delinquencies, repossessions, foreclosures and losses generally increase during economic slowdowns or recessions. For the Company's finance customers, loss of employment, increases in cost-of-living or other adverse economic conditions would impair their ability to meet their payment obligations. Higher industry inventory levels of repossessed manufactured houses may affect recovery rates and result in future impairment charges and provision for losses. In addition, in an economic slowdown or recession, servicing and litigation costs generally increase. Any sustained period of increased delinquencies, repossessions, foreclosures, losses or increased costs would adversely affect the Company's financial condition, results of operations and liquidity. The Company bears the risk of delinquency and default on securitized loans in which it has a residual or retained ownership interest. The Company also reacquires the risks of delinquency and default for loans that it is obligated to repurchase. Repurchase obligations are typically triggered in sales or securitizations if the loan materially violates the Company's representations or warranties.

The availability of sufficient sources of capital to allow the Company to continue its operations is dependent on numerous factors, many of which are outside its control. Relatively small amounts of capital are required for the Company's ongoing operations and cash generated from operations should be adequate to fund the continued operations.

# ORIGEN FINANCIAL, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2011 and 2010

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### **NOTE 15 - Lease Commitments**

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The Company leases office facilities and equipment under leasing agreements that expire at various dates. These leases generally contain scheduled rent increases or escalation clauses and/or renewal options. Future minimum rental payments under agreements classified as operating leases with non-cancelable terms at December 31, 2011 were as follows (in thousands):

2012	\$	113
2013		115
2014		113
Thereafter		165
Total	\$	<u>506</u>

For the years ended December 31, 2011 and 2010, rental and operating lease expense amounted to approximately \$300,000 and \$567,000, respectively. The Company did not pay any contingent rental expense and received approximately \$46,000 and \$78,000 in sublease income during the years ended December 31, 2011 and 2010, respectively.

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### **NOTE 16 - Fair Value Measurements**

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On January 1, 2008, the Company adopted guidance related to fair value measurements and additional guidance for financial instruments. This guidance establishes a framework for measuring fair value and expands disclosures about fair value measurements. The updated guidance was issued to establish a uniform definition of fair value. The definition of fair value under this guidance is market based as opposed to company specific and includes the following:

- Defines fair value as the price that would be received to sell an asset or paid to transfer a liability, in either case through an orderly transaction between market participants at a measurement date, and establishes a framework for measuring fair value;
- Establishes a three level hierarchy for fair value measurements based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date;
- Nullifies previous fair value guidance, which required the deferral of profit at inception of a transaction involving a derivative financial instrument in the absence of observable data supporting the valuation technique;
- Eliminates large position discounts for financial instruments quoted in active markets and requires consideration of the company's creditworthiness when valuing liabilities; and
- Expands disclosures about instruments that are measured at fair value.

The accounting guidance for financial instruments provides an option to elect fair value as an alternative measurement for selected financial assets, financial liabilities, unrecognized Company commitments and written loan commitments not previously recorded at fair value. The Company has not elected to apply the fair value option for any financial instruments.

# ORIGEN FINANCIAL, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2011 and 2010

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### **NOTE 16 - Fair Value Measurements (cont.)**

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#### **Determination of Fair Value**

The Company has an established process for determining fair values. Fair value is based upon quoted market prices, where available. If listed prices or quotes are not available, fair value is based upon internally developed models that use primarily market-based or independently-sourced market parameters, including interest rate yield curves and option volatilities. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments include amounts to reflect counterparty credit quality, creditworthiness, liquidity and unobservable parameters that are applied consistently over time. Any changes to the valuation methodology are reviewed by management to determine appropriateness of the changes. As markets develop and the pricing for certain products becomes more transparent, the Company expects to continue to refine its valuation methodologies.

The methods described above may produce a fair value estimate that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Company believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in different estimates of fair values of the same financial instruments at the reporting date.

#### **Valuation Hierarchy**

The accounting guidance for fair value measurements and disclosures establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy favors the transparency of inputs to the valuation of an asset or liability as of the measurement date and thereby favors use of Level 1 if appropriate information is available, and otherwise Level 2 and finally Level 3 if Level 2 input is not available. The three levels are defined as follows.

- Level 1 — Fair value is based upon quoted prices (unadjusted) for identical assets or liabilities in active markets in which the Company can participate.
- Level 2 — Fair value is based upon quoted prices for similar (i.e., not identical) assets and liabilities in active markets, and other inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3 — Fair value is based upon financial models using primarily unobservable inputs.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input within the valuation hierarchy that is significant to the fair value measurement.

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

# ORIGEN FINANCIAL, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2011 and 2010

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### **NOTE 16 - Fair Value Measurements (cont.)**

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#### **Assets**

*Investments - "SOP – 03-3"* - These securities are comprised of mortgage-backed securities that have evidence of deterioration of credit quality at purchase. The fair values are determined by using a discounted cash flow model. Due to illiquidity in the markets, the Company determined the fair value of these securities using internal valuation models and therefore classified them within the Level 3 valuation hierarchy as these models utilize significant inputs which are unobservable.

#### *Loans receivable*

The Company does not record these loans at fair value on a recurring basis. However, from time to time a loan is considered impaired and an allowance for loan losses is established. Loans are considered impaired if it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement. Once a loan is identified as impaired, the fair value of the impaired loan is estimated using one of several methods, including collateral value, market value of similar debt, enterprise value, and liquidation value or discounted cash flows. Impaired loans do not require an allowance if the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At December 31, 2011, substantially all of the total impaired loans were evaluated based on the fair value of the collateral rather than on discounted cash flows. Impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the impaired loan as a nonrecurring Level 2 valuation.

#### *Repossessed houses*

Loans on which the underlying collateral has been repossessed are adjusted to fair value upon transfer to repossessed assets. Subsequently, repossessed assets are carried at the lower of carrying value or fair value, less anticipated marketing and selling costs. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the repossessed asset as a nonrecurring Level 2 valuation.

#### *Derivative Financial Instruments*

The Company's derivative contracts include only interest rate swaps, and are valued by comparing similar assets in an active market with inputs that are observable and are classified within Level 2 of the valuation hierarchy.

#### **Liabilities**

#### *Warrants*

Warrant liabilities are valued using a Cox, Ross, Rubinstein lattice model. Significant assumptions include expected volatility, a risk free rate and an expected life. The Company records the warrants as a nonrecurring Level 2 valuation. There were no warrants outstanding at December 31, 2011.

# ORIGEN FINANCIAL, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2011 and 2010

### **NOTE 16 - Fair Value Measurements (cont.)**

Assets and liabilities measured at fair value on a recurring basis are summarized below (dollars in thousands):

	December 31, 2011			
	Fair Value Measurement Using			Assets/Liabilities at Fair Value
	Level 1	Level 2	Level 3	
Assets				
Derivatives	\$ -	\$ 472	\$ -	\$ 472
Total assets	\$ -	\$ 472	\$ -	\$ 472
Liabilities				
Derivatives	\$ -	\$ 41,662	\$ -	\$ 41,662
Total liabilities	\$ -	\$ 41,662	\$ -	\$ 41,662
	December 31, 2010			
	Fair Value Measurement Using			Assets/Liabilities at Fair Value
	Level 1	Level 2	Level 3	
Assets				
Derivatives	\$ -	\$ 409	\$ -	\$ 409
Total assets	\$ -	\$ 409	\$ -	\$ 409
Liabilities				
Derivatives	\$ -	\$ 37,090	\$ -	\$ 37,090
Total liabilities	\$ -	\$ 37,090	\$ -	\$ 37,090

Derivative assets are included in other assets on the balance sheet.

The Company did not have any assets or liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3).

## ORIGEN FINANCIAL, INC.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2011 and 2010

#### **NOTE 16 - Fair Value Measurements (cont.)**

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

December 31, 2011				
Fair Value on a Non-recurring Basis				
	Level 1	Level 2	Level 3	Asset/Liability at Fair Value
Investments-SOP – 03-3	\$ -	\$ 1,707	\$ -	\$ 1,707
Impaired loans	-	1,685	-	1,685
Repossessed assets	-	2,512	-	2,512
Total Asset	\$ -	\$ 5,904	\$ -	\$ 5,904

December 31, 2010				
Fair Value on a Non-recurring Basis				
	Level 1	Level 2	Level 3	Asset/Liability at Fair Value
Investment-SOP – 03-3	\$ -	\$ 1,996	\$ -	\$ 1,996
Impaired loans	-	2,441	-	2,441
Repossessed houses	-	6,705	-	6,705
Total Asset	\$ -	\$ 11,142	\$ -	\$ 11,142

# ORIGEN FINANCIAL, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2011 and 2010

### NOTE 16 - Fair Value Measurements (cont.)

#### Required Financial Disclosure about Financial Instruments

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

	2011		2010	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
<b>Assets</b>				
Cash and cash equivalents	\$ 3,740	\$ 3,740	\$ 2,595	\$ 2,595
Restricted cash	9,767	9,767	9,981	9,981
Investments	1,707	1,707	1,996	1,996
Loans receivable	628,708	564,969	716,900	637,554
Derivatives	472	472	409	409
<b>Liabilities</b>				
Securitization financing	560,724	441,196	627,334	508,625
Derivatives	41,662	41,662	37,090	37,090

The methods and assumptions that were used to estimate the fair value of financial assets and financial liabilities that are measured at fair value on a recurring or non-recurring basis are discussed above. The following methods and assumptions were used to estimate the fair value for other financial instruments for which it is practicable to estimate that value:

- *Cash, cash equivalents and restricted cash* - Due to their short term in nature, the carrying amount of cash, cash equivalents, and restricted cash approximates fair value.
- *Investment-Held-to-Maturity* - The fair value of investments, classified as held to maturity, is estimated by management using an internally developed cash flow model using market interest rates inputs as well as management's best estimates of spreads for similar collateral.
- *Loans Receivable* - The fair value of loans is estimated by using internally developed discounted cash flow models using market interest rate inputs as well as management's best estimate of spreads for similar collateral.
- *Securitized Financing* - The fair value of securitized financing is estimated based on a discounted cash flow model that incorporates the current borrowing rates of the notes or similar types of borrowing arrangements.

## ORIGEN FINANCIAL, INC.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 2011 and 2010

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#### **NOTE 17 - Related Party Transactions**

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The Company leases its executive offices in Southfield, Michigan from an entity in which Mr. Gary A. Shiffman, a director of the Company, and certain of his affiliates beneficially own approximately a 21% interest. Ronald A. Klein, a director and the Chief Executive Officer of the Company, owns less than a 1% interest in the landlord entity. The Company recorded rental expense for these offices of approximately \$291,000 and \$559,000 for the years ended December 31, 2011 and 2010, respectively.

In November 2008 the Company entered into an agreement with Viva Beverages LLC ("Viva") to sublease approximately 5,200 square feet of the Company's executive office space in Southfield, Michigan. Mr. Shiffman owns approximately 46.7% of Viva's equity interests and one of his children owns approximately 6.7% of Viva's interests. The term of the sublease ran through August 2011. There were approximately \$11,000 and \$35,000 in sublease payments for the years ended December 31, 2011 and 2010, respectively.

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#### **NOTE 18 - Subsequent Events**

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The Company has evaluated subsequent events occurring through March 9, 2012, the date that the financial statements were available to be issued for events requiring recording or disclosure in the Company's financial statements.