Walker & Dunlop, Inc.
Form 10-Q
May 09, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2013

OR

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

For the transition period from to

Commission File Number: 001-35000

Walker & Dunlop, Inc.

(Exact name of registrant as specified in its charter)

Maryland	**80-0629925**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

7501 Wisconsin Avenue, Suite 1200E

Bethesda, Maryland 20814

(301) 215-5500

(Address, including zip code, and telephone number, including area code, of registrant s principal executive offices)

Not Applicable

(Former name, former address, and former fiscal year if changed since last report)

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

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

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

Large accelerated filer o	Accelerated filer x
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

As of May 6, 2013 there were 34,966,265 total shares of common stock outstanding.

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PART I

FINANCIAL INFORMATION

Item 1. Financial Statements

Walker & Dunlop, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

March 31, 2013 and December 31, 2012

(In thousands, except share and per share data)

	March 31 2013 (unaudited)	December 31, 2012
Assets		
Cash and cash equivalents	$ 65,405	$ 65,027
Restricted cash	7,750	7,130
Pledged securities, at fair value	34,581	33,481
Loans held for sale, at fair value	479,779	1,101,561
Loans held for investment	9,487	9,468
Servicing fees and other receivables, net	29,416	40,933
Derivative assets	8,306	21,258
Mortgage servicing rights	336,397	315,524
Goodwill	59,969	59,735
Intangible assets	3,348	4,644
Other assets	25,117	29,872
Total assets	$ 1,059,555	$ 1,688,633
Liabilities and Stockholders Equity		
Liabilities		
Accounts payable and other accruals	$ 36,346	$ 66,763
Performance deposits from borrowers	6,694	9,503
Derivative liabilities	3,936	867
Guaranty obligation, net of accumulated amortization	22,352	21,155
Allowance for risk-sharing obligations	16,071	15,670
Deferred tax liability	56,035	56,035
Warehouse notes payable	476,221	1,084,539
Notes payable	78,850	80,925
Total liabilities	$ 696,505	$ 1,335,457
Stockholders Equity		
Stockholders equity:		

Preferred shares, Authorized 50,000,000, none issued.	$		$	
Common stock, $0.01 par value. Authorized 200,000,000; issued and outstanding 33,613,832 shares in 2013 and 33,567,730 shares in 2012.		336		336
Additional paid-in capital		238,971		236,823
Retained earnings		123,743		116,017
Total stockholders equity	$	363,050	$	353,176
Commitments and contingencies				
Total liabilities and stockholders equity	$	1,059,555	$	1,688,633

See accompanying notes to condensed consolidated financial statements.

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Walker & Dunlop, Inc. and Subsidiaries

Condensed Consolidated Statements of Income

(In thousands, except share and per share data)

(Unaudited)

	For the three months ended March 31,			
	2013		2012	
Revenues				
Gains from mortgage banking activities	$	42,931	$	19,802
Servicing fees		21,141		9,379
Net warehouse interest income		1,623		937
Escrow earnings and other interest income		942		539
Other		2,548		3,745
Total revenues	$	69,185	$	34,402
Expenses				
Personnel	$	28,283	$	11,641
Amortization and depreciation		17,256		7,241
Amortization of intangible assets		1,296		18
Provision for risk-sharing obligations		401		1,224
Interest expense on corporate debt		968		168
Other operating expenses		8,651		4,616
Total expenses	$	56,855	$	24,908
Income from operations	$	12,330	$	9,494
Income tax expense		4,604		3,655
Net income	$	7,726	$	5,839
Basic earnings per share	$	0.23	$	0.27
Diluted earnings per share	$	0.23	$	0.27
Basic weighted average shares outstanding		33,570,130		21,750,573
Diluted weighted average shares outstanding		34,156,760		21,848,280

See accompanying notes to condensed consolidated financial statements.

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Walker & Dunlop, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

	Three Months Ended March 31,	
	2013	2012
Cash flows from operating activities:		
Net income	$ 7,726	$ 5,839
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Gains attributable to fair value of future servicing rights, net of guaranty obligation	(20,671)	(9,523)
Gains attributable to fair value of premium and origination fees	13,339	14
Gain on sale of MSR, less prepayment of MSR		(2)
Provision for risk-sharing obligations	401	1,224
Amortization and depreciation	18,552	7,259
Originations of loans held for sale	(1,575,750)	(648,055)
Sales of loans to third parties	2,184,346	641,398
Amortization of deferred loan fees and costs	(19)	(4)
Stock compensation	2,160	681
Tax benefit from vesting of equity awards	(161)	
Amortization of leasehold inducement		39
Cash allowance received from landlord		1,301
Cash paid to settle risk-sharing obligations		(1,619)
Changes in:		
Restricted cash and pledged securities	(1,720)	1,441
Servicing fees and other receivables	11,348	3,305
Derivative fair value adjustments		15
Other assets	5,880	(85)
Accounts payable and other accruals	(30,651)	(19,986)
Performance deposits from borrowers	(2,809)	(4,619)
Net cash provided by (used in) operating activities	$ 611,971	$ (21,377)
Cash flows from investing activities:		
Capital expenditures	$ (1,188)	$ (1,922)
Net increase in loans held for investment		(6,943)
Net cash used in investing activities	$ (1,188)	$ (8,865)
Cash flows from financing activities:		
(Repayments) borrowings of warehouse notes payable, net	$ (608,318)	$ 18,259
Repayments of notes payable	(2,075)	(900)
Proceeds from issuance of common stock	119	1
Repurchase of common stock	(292)	(124)
Tax benefit from vesting of equity awards	161	
Net cash (used in) provided by financing activities	$ (610,405)	$ 17,236
Net increase (decrease) in cash and cash equivalents	$ 378	$ (13,006)
Cash and cash equivalents at beginning of period	65,027	53,817
Cash and cash equivalents at end of period	$ 65,405	$ 40,811
Supplemental Disclosure of Cash Flow Information:		
Cash paid to third parties for interest	$ 4,762	$ 1,180

Cash paid for taxes	$	194	$	3,314

See accompanying notes to condensed consolidated financial statements.

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NOTE 1 ORGANIZATION AND BASIS OF PRESENTATION

These financial statements represent the condensed consolidated financial position and results of operations of Walker & Dunlop, Inc. and its subsidiaries. Unless the context otherwise requires, references to we, us, our, Walker & Dunlop and the Company mean the Walker & Dunlo consolidated companies. The statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. Because the accompanying condensed consolidated financial statements do not include all of the information and footnotes required by GAAP, they should be read in conjunction with the financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2012 (2012 Form 10-K). In the opinion of management, all adjustments (consisting only of normal recurring accruals except as otherwise noted herein) considered necessary for a fair presentation of the results for the Company in the interim periods presented have been included. Results of operations for the three months ended March 31, 2013 are not necessarily indicative of the results that may be expected for the year ending December 31, 2013, or thereafter.

Walker & Dunlop is one of the leading commercial real estate finance companies in the United States, with a primary focus on multifamily lending. The Company originates, sells and services a range of multifamily and other commercial real estate financing products. The Company s clients are owners and developers of commercial real estate across the country. The Company originates and sells loans pursuant to the programs of the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac, and together with Fannie Mae, the government-sponsored enterprises, or the GSEs), the Government National Mortgage Association (Ginnie Mae) and the Federal Housing Administration, a division of the U.S. Department of Housing and Urban Development (together with Ginnie Mae, HUD), with which Walker & Dunlop has long-established relationships. The Company retains servicing rights and asset management responsibilities on nearly all loans that it sells to GSEs and HUD. Walker & Dunlop is approved as a Fannie Mae Delegated Underwriting and Servicing (DUS TM) lender nationally, a Freddie Mac Program Plus lender in 22 states and the District of Columbia, a HUD Multifamily Accelerated Processing (MAP) lender nationally, a HUD Section 232 LEAN lender nationally, and a Ginnie Mae issuer. The Company also originates and services loans for a number of life insurance companies and other institutional investors, in which cases it does not fund the loan but rather acts as a loan broker. Additionally, through our subsidiary entities, we provide institutional advisory, asset management, and investment management services specializing in debt, structured debt, and equity financing for commercial real estate.

The Company offers an interim loan program offering floating-rate debt, for terms of up to two years, to experienced borrowers seeking to acquire or reposition multifamily properties that do not currently qualify for permanent financing (the Program). The Company closed its first loans under the Program in 2012. The Company underwrites all loans originated through the Program. During the time they are outstanding, the Company assumes the full risk of loss on the loans. In addition, the Company services and asset-manages loans originated through the Program, with the ultimate goal of providing permanent financing on the properties. These loans are classified as held for investment on the Company s balance sheet during such time that they are outstanding.

On September 4, 2012, the Company closed its acquisition of CWCapital, LLC (CWCapital), at which time the total consideration transferred was valued at approximately $231.1 million, consisting of $80.0 million in cash and the Company s issuance in a private placement to CW Financial Services, LLC (CW Financial) of approximately 11.6 million shares of common stock valued at approximately $151.1 million (the Acquisition). Upon closing of the Acquisition, CWCapital became an indirect wholly owned subsidiary of the Company and was renamed Walker & Dunlop Capital, LLC. By virtue of the Company s ownership of CWCapital, the Company also acquired a 50% ownership in ARA Finance LLC, a joint venture with ARA Finco LLC, in which ARA Finco LLC owns the remaining 50% of ARA Finance LLC. The Company does not have the ability to direct the activities of ARA Finance LLC; therefore, the Company accounts for its investment in ARA Finance LLC under the equity method of accounting.

The results of operations for the three months ended March 31, 2013 reflect the impact of the Acquisition, which materially affects the comparability to the prior year.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation The condensed consolidated financial statements include the accounts of the Company and all of its consolidated entities. All material intercompany transactions have been eliminated. The Company has evaluated all subsequent events.

Use of Estimates The preparation of condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, including guaranty obligations, capitalized mortgage servicing rights, derivative instruments and hedging relationships, and the disclosure of contingent assets and liabilities. Actual results may vary from these estimates.

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Comprehensive Income For the three months ended March 31, 2013 and 2012, comprehensive income equaled net income; therefore, a separate statement of comprehensive income is not included in the accompanying condensed consolidated financial statements.

Net Warehouse Interest Income The Company presents warehouse interest income net of warehouse interest expense. Warehouse interest income is the interest earned from loans that are held for sale and those held for investment. Substantially all loans that are held for sale or for investment are financed with matched borrowings under our warehouse facilities incurred to fund a specific loan held for sale. Warehouse interest expense is incurred on borrowings used to fund loans solely while they are held for sale or for investment. Warehouse interest income and expense are earned or incurred on loans held for sale after a loan is closed and before a loan is sold. Warehouse interest income and expense are earned or incurred on loans held for investment after a loan is closed and before a loan is repaid. Included in net warehouse interest income for the three months ended March 31, 2013 and 2012 are the following components (in thousands):

	For the three months ended March 31,			
	2013		2012	
Warehouse interest income	$	5,447	$	2,575
Warehouse interest expense		3,824		1,638
Net warehouse interest income	$	1,623	$	937

Recently Issued Accounting Pronouncements In December 2011, the FASB issued ASU No. 2011-11, *Disclosures about Offsetting Assets and Liabilities*. The ASU requires enhanced disclosures that will enable users of the financial statements to evaluate the effect or potential effect of netting arrangements on an entity s financial position. This includes the effect or potential effect of rights of setoff associated with an entity s recognized assets and recognized liabilities within the scope of the ASU. The FASB issued a subsequent ASU limiting the scope of ASU No. 2011-11 to derivatives, repurchase and reverse repurchase agreements, and securities borrowing and lending agreements subject to master netting arrangements or similar agreements. The ASU is effective for annual periods beginning on or after January 1, 2013 (and interim periods within those annual periods), with retrospective application required. The adoption of ASU No. 2011-11 on January 1, 2013 did not have an impact on the Company s financial statements.

In July 2012, the FASB issued ASU No. 2012-02*, Testing Indefinite-Lived Intangible Assets for Impairment*. ASU No. 2012-02 allows an entity to first assess qualitative factors to determine whether it is necessary to perform a quantitative impairment test. Under these amendments, an entity would not be required to calculate the fair value of an indefinite-lived intangible asset unless the entity determines, based on qualitative assessment, that it is not more likely than not, the indefinite-lived intangible asset is impaired. The amendments include a number of events and circumstances for an entity to consider in conducting the qualitative assessment. The ASU is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012, with early adoption permitted. The adoption of ASU No. 2012-02 on January 1, 2013 did not have a material impact on the Company s financial statements.

In February 2013, The FASB issued ASU No. 2013-02, *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*. Among other things, an entity is required to present either parenthetically on the face of the financial statements or in the notes, significant amounts reclassified from each component of accumulated other comprehensive income and the income statement line items affected by the reclassification. An entity does not need to show the income statement line item affected for certain components that are not required to be reclassified in their entirety to net income, such as amounts amortized into net periodic pension cost. The ASU is effective for annual periods, and interim periods within those periods, beginning after December 15, 2012. The adoption of ASU No. 2013-02 on January 1, 2013 did not have an impact on the Company s financial statements.

There have been no material changes to the accounting policies discussed in Note 2 of the Company s 2012 Form 10-K.

The Company has made certain immaterial reclassifications to prior-year balances to conform to current-year presentation.

NOTE 3 GOODWILL AND OTHER INTANGIBLE ASSETS

The following summarizes the Company s goodwill activity for the three months ended March 31, 2013 (in thousands):

	For the three months ended, March 31, 2013	
Beginning balance	$	59,735
Retrospective adjustments		234
Impairment		
Ending balance	$	59,969

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The Company provisionally allocated the purchase price to the assets acquired, separately identifiable intangible assets, and liabilities assumed related to the Acquisition based on their estimated acquisition date fair values. A change to the provisional amounts recorded for assets acquired, identifiable intangible assets, and liabilities assumed during the measurement period affects the amount of the purchase price allocated to goodwill. Such changes to the purchase price allocation during the measurement period are recorded as retrospective adjustments to the consolidated financial statements. During the three months ended March 31, 2013, the Company identified immaterial adjustments to certain of the provisional amounts recorded as shown in the table above. The adjustments were recorded based on information obtained subsequent to the acquisition date that related to information that existed as of the acquisition date.

The Purchase Agreement required the seller to provide the Company with a minimum working capital balance at the acquisition date. To the extent actual working capital on the acquisition date exceeded or fell below the minimum requirement, the Company would either pay or receive funds from the seller. On January 16, 2013, the Company and the seller agreed to extend the settlement of the working capital adjustment until certain servicing related receivables are finalized. The Company continues to recognize provisional amounts in its purchase price allocation related to these items as of March 31, 2013 as the settlement of working capital was not finalized as of March 31, 2013. Any adjustments to the provisional amounts recognized will be made upon finalization of working capital. We do not expect these adjustments to have a material impact on goodwill.

The following summarizes the Company s other intangible assets, related to the Acquisition, as of March 31, 2013 (in thousands):

	As of March 31, 2013		
	Gross carrying value	**Accumulated amortization**	**Net carrying value**
Mortgage pipeline intangible asset	$ 18,700	(16,460)	$ 2,240
Mortgage servicing rights	124,629	(15,046)	109,583
	$ 143,329	$ (31,506)	$ 111,823

The Company expects to amortize in 2013 the remaining March 31, 2013 net carrying value of the mortgage pipeline intangible asset. The expected amortization of Mortgage Servicing Rights (MSRs), which includes the MSRs acquired from CWCapital shown above, is disclosed in Note 5.

NOTE 4 GAINS FROM MORTGAGE BANKING ACTIVITIES

The gains from mortgage banking activities consisted of the following activity for the three months ended March 31, 2013 and 2012 (in thousands):

	For the three months ended March 31,	
	2013	**2012**
Contractual loan origination related fees, net	$ 22,260	$ 10,279
Fair value of expected future cash flows from servicing recognized at commitment	21,871	10,083
Fair value of expected guaranty obligation	(1,200)	(560)

Total gains from mortgage banking activities	$	42,931	$	19,802

The origination fees shown in the table above are net of co-broker fees of $3.3 million and $3.5 million for the three months ended March 31, 2013 and 2012, respectively.

NOTE 5 MORTGAGE SERVICING RIGHTS

MSRs represent the fair value of the servicing rights retained by the Company for mortgage loans originated and sold. The capitalized amount is equal to the estimated fair value of the expected net cash flows associated with the servicing rights. The following describes the key assumptions used in calculating each loan s MSR:

Discount rate Depending upon loan type, the discount rate used is management s best estimate of market discount rates. The rates used for loans originated were 10% to 15% for each of the three-month periods presented.

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Estimated Life The estimated life of the MSRs is derived based upon the stated yield maintenance and/or prepayment protection term of the underlying loan and may be reduced by 6 to 12 months based upon the expiration of various types of prepayment penalty and/or lockout provisions prior to that stated maturity date.

Servicing Cost The estimated future cost to service the loan for the estimated life of the MSR is subtracted from the estimated future cash flows.

The fair value of the MSRs was $373.7 million and $350.5 million at March 31, 2013 and December 31, 2012, respectively. The Company uses a discounted static cash flow valuation approach and the key economic assumption is the discount rate. For example see the following sensitivities:

The impact of a 100 basis point increase in the discount rate at March 31, 2013, is a decrease in the fair value of $11.7 million.

The impact of a 200 basis point increase in the discount rate at March 31, 2013, is a decrease in the fair value of $22.7 million.

Activity related to capitalized MSRs for the three months ended March 31, 2013 and 2012 was as follows (in thousands):

	For the three months ended March 31,	
	2013	**2012**
Beginning balance	$ 315,524	$ 137,079
Additions, following the sale of loan	38,793	13,027
Amortization	(15,105)	(6,350)
Pre-payments and write-offs	(2,815)	(1,135)
Ending balance	$ 336,397	$ 142,621

The expected amortization of MSR balances recorded as of March 31, 2013 is shown below (in thousands):

	Originated MSRs Amortization	Acquired MSRs Amortization	Total MSRs Amortization
Nine Months Ending December 31,			
2013	$ 29,436	$ 15,732	$ 45,168
Year Ending December 31,			
2014	36,686	19,565	56,251
2015	32,065	17,867	49,932
2016	29,565	16,400	45,965
2017	26,547	14,387	40,934
2018	22,576	10,468	33,044

Thereafter	49,939	15,164	65,103
Total	$ 226,814	$ 109,583	$ 336,397

NOTE 6 GUARANTY OBLIGATION AND ALLOWANCE FOR RISK-SHARING OBLIGATIONS

When a loan is sold under the Fannie Mae DUS program, the Company typically agrees to guarantee a portion of the ultimate loss incurred on the loan should the borrower fail to perform. The compensation for this risk is a component of the servicing fee on the loan. No guaranty is provided for loans sold under the Freddie Mac or HUD loan programs.

A summary of our guaranty obligation for the three months ended March 31, 2013 and 2012 is as follows (in thousands):

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	For the three months ended March 31,	
	2013	2012
Beginning balance	$ 21,155	$ 9,921
Guaranty obligation recognized, following the sale of loan	2,154	1,002
Amortization of guaranty obligation	(957)	(476)
Ending Balance	$ 22,352	$ 10,447

The Company evaluates the allowance for risk-sharing obligations by monitoring the performance of each loan for triggering events or conditions that may signal a potential default. In situations where payment under the guaranty is probable and estimable on a specific loan, the Company records an additional liability for the estimated allowance for risk-sharing through a charge to the provision for risk-sharing obligations in the income statement, along with a write-off of the loan-specific MSR. The amount of the provision reflects our assessment of the likelihood of payment by the borrower, the estimated disposition value of the underlying collateral and the level of risk-sharing. Historically, the loss recognition occurs at or before the loan becoming 60 days delinquent. A summary of our allowance for risk-sharing for the three months ended March 31, 2013 and 2012 is as follows (in thousands):

	For the three months ended March 31,	
	2013	2012
Beginning balance	$ 15,670	$ 14,917
Provision for risk sharing obligations	401	1,224
Write-offs		(1,619)
Ending Balance	$ 16,071	$ 14,522

As of March 31, 2013, the maximum quantifiable contingent liability associated with the Company s guarantees under the Fannie Mae DUS agreement was $2.8 billion. The maximum quantifiable contingent liability is not representative of the actual loss the Company would incur. The Company would be liable for this amount only if all of the loans it services for Fannie Mae, for which the Company retains some risk of loss, were to default and all of the collateral underlying these loans was determined to be without value at the time of settlement.

NOTE 7 SERVICING

The total unpaid principal balance of loans the Company was servicing for various institutional investors was $36.8 billion as of March 31, 2013 compared to $16.9 billion as of March 31, 2012.

NOTE 8 WAREHOUSE NOTES PAYABLE

The maximum borrowing amounts and outstanding balances under the warehouse notes payable as of March 31, 2013 were as follows (in thousands):

Facility		Maximum Amount		Outstanding Balance	Interest rate
Committed warehouse facility #1	$	575,000	$	284,095	Average 30-day LIBOR plus 1.85%
Committed warehouse facility #2		450,000		176,801	Average 30-day LIBOR plus 1.75%
Committed warehouse facility #3		35,000		7,125	Average 30-day LIBOR plus 2.50%
Committed warehouse facility #4		50,000			Average 30-day LIBOR plus 2.50%
Fannie Mae Repurchase agreement, uncommited line and open maturity		500,000		8,200	Average 30-day LIBOR plus 1.15%
Total	$	1,610,000	$	476,221	

On April 2, 2013, the Company executed an amendment to the warehouse agreement related to warehouse facility #2, reducing the interest rate under the line to 30-day LIBOR plus 150 basis points. No other material modifications were made to the agreement.

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On April 12, 2013, the Company executed an amendment to the warehousing agreement related to warehouse facility #1, reducing the interest rate under the line to 30-day LIBOR plus 165 basis points. No other material modifications were made to the agreement.

NOTE 9 FAIR VALUE MEASUREMENTS

The Company uses valuation techniques that are consistent with the market approach, the income approach and/or the cost approach to measure assets and liabilities that are measured at fair value. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity s own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. In that regard, accounting standards establish a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

- *Level 1* Financial assets and liabilities whose values are based on unadjusted quoted prices in active markets for identical assets or liabilities that the Company has the ability to access.

- *Level 2* Financial assets and liabilities whose values are based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (such as interest rates, volatilities, prepayment speeds, credit risks, etc.) or inputs that are derived principally from or corroborated by market data by correlation or other means.

- *Level 3* Financial assets and liabilities whose values are based on inputs that are both unobservable and significant to the overall valuation.

The Company s MSRs are measured at fair value on a nonrecurring basis. That is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The Company s MSRs do not trade in an active, open market with readily observable prices. While sales of MSRs do occur, precise terms and conditions vary with each transaction and are not readily available. Accordingly, the estimated fair value of MSRs was developed using discounted cash flow models that calculate the present value of estimated future net servicing income. The model considers contractually specified servicing fees, prepayment assumptions, delinquency rates, late charges, other ancillary revenue, costs to service and other economic factors. The Company reassesses and periodically adjusts the underlying inputs and assumptions used in the model to reflect observable market conditions and assumptions that a market participant would consider in valuing an MSR asset. MSRs are carried at the lower of amortized cost or estimated fair value.

A description of the valuation methodologies used for assets and liabilities measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below. These valuation methodologies were applied to all of the Company s assets and liabilities carried at fair value:

- *Derivative Instruments* The derivative positions consist of interest rate lock commitments and forward sale agreements. These instruments are valued using a discounted cash flow model developed based on changes in the U.S. Treasury rate and other observable market data. The value was determined after considering the potential impact of collateralization, adjusted to reflect nonperformance risk of both the counterparty and the Company and are classified within Level 3 of the valuation hierarchy.

- *Loans held for sale* The loans held for sale are reported at fair value. The Company determines the fair value of the loans held for sale using discounted cash flow models that incorporate quoted observable prices from market participants. Therefore, the Company classifies these loans held for sale as Level 2.

- *Pledged Securities* The pledged securities are valued using quoted market prices from recent trades. Therefore, the Company classifies pledged securities as Level 1.

The following table summarizes financial assets and financial liabilities measured at fair value on a recurring basis as of March 31, 2013, and December 31, 2012, segregated by the level of the valuation inputs within the fair value hierarchy used to measure fair value (in thousands):

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	Quoted Prices in Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)	Balance as of Period End
March 31, 2013				
Assets				
Loans held for sale	$	$ 479,779	$	$ 479,779
Pledged securities	34,581			34,581
Derivative assets			8,306	8,306
Total	$ 34,581	$ 479,779	$ 8,306	$ 522,666
Liabilities				
Derivative liabilities	$	$	$ 3,936	$ 3,936
Total	$	$	$ 3,936	$ 3,936
December 31, 2012				
Assets				
Loans held for sale	$	$ 1,101,561	$	$ 1,101,561
Pledged securities	33,481			33,481
Derivative assets			21,258	21,258
Total	$ 33,481	$ 1,101,561	$ 21,258	$ 1,156,300
Liabilities				
Derivative liabilities	$	$	$ 867	$ 867
Total	$	$	$ 867	$ 867

There were no transfers between any of the levels within the fair value hierarchy during the three months ended March 31, 2013.

Derivative instruments (Level 3) are outstanding for short periods of time (generally less than 60 days) and are not outstanding for more than one period. A roll forward of derivative instruments which require valuations based upon significant unobservable inputs, is presented below for the three months ended March 31, 2013 and 2012 (in thousands):

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	Fair Value Measurements Using Significant Unobservable Inputs:
	Derivative Instruments Three Months Ended March 31, 2013
Derivative assets and liabilities, net	
Beginning balance, December 31, 2012	$ 20,391
Settlements	(58,951)
Realized gains recorded in earnings (1)	38,560
Unrealized gains recorded in earnings (1)	4,370
Ending balance, March 31, 2013	$ 4,370

	Derivative Instruments Three Months Ended March 31, 2012
Derivative assets and liabilities, net	
Beginning balance, December 31, 2011	$ 5,415
Settlements	(15,715)
Realized gains recorded in earnings (1)	10,300
Unrealized gains recorded in earnings (1)	9,502
Ending balance, March 31, 2012	$ 9,502

(1) Realized and unrealized gains from derivatives are recognized in the gains from mortgage banking activities line item in the Condensed Consolidated Statements of Income.

The following table presents information about significant unobservable inputs used in the measurement of the fair value of the Company s Level 3 assets and liabilities (in thousands):

	Quantitative Information about Level 3 Measurements			
	Fair Value	Valuation Technique	Unobservable Input (1)	Input Value (1)
Derivative assets	$ 8,306	Discounted cash flow	Counterparty credit risk	
Derivative liabilities	3,936	Discounted cash flow	Counterparty credit risk	

(1) Significant increases (decreases) in this input may lead to significantly lower (higher) fair value measurements.

The carrying amounts and the fair values of the Company s financial instruments as of March 31, 2013, and December 31, 2012, are presented below (in thousands):

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	March 31, 2013		December 31, 2012	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial Assets:				
Cash and cash equivalents	$ 65,405	$ 65,405	$ 65,027	$ 65,027
Restricted cash	7,750	7,750	7,130	7,130
Pledged securities	34,581	34,581	33,481	33,481
Loans held for sale	479,779	479,779	1,101,561	1,101,561
Loans held for investment	9,487	9,500	9,468	9,500
Derivative assets	8,306	8,306	21,258	21,258
Total financial assets	$ 605,308	$ 605,321	$ 1,237,925	$ 1,237,957
Financial Liabilities:				
Derivative liabilities	$ 3,936	$ 3,936	$ 867	$ 867
Warehouse notes payable	476,221	476,221	1,084,539	1,084,539
Notes payable	78,850	78,850	80,925	80,925
Total financial liabilities	$ 559,007	$ 559,007	$ 1,166,331	$ 1,166,331

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

Cash and Cash Equivalents and Restricted Cash The carrying amounts, at face value or cost plus accrued interest, approximate fair value because of the short maturity of these instruments (Level 1).

Pledged Securities Consist of highly liquid investments in commercial paper of AAA rated entities and investments in money market accounts invested in government securities. Investments typically have maturities of 90 days or less, and are valued using quoted market prices from recent trades.

Loans Held For Sale Consist of originated loans that are generally transferred or sold within 60 days from the date that a mortgage loan is funded, and are valued using discounted cash flow models that incorporate observable prices from market participants.

Loans Held For Investment Consist of originated interim loans which the Company expects to hold for investment for periods of up to two years, and are valued using discounted cash flow models that incorporate observable prices from market participants (Level 2).

Derivative Instruments Consist of interest rate lock commitments and forward sale agreements. These instruments are valued using discounted cash flow models developed based on changes in the U.S. Treasury rate and other observable market data. The value is determined after considering the potential impact of collateralization, adjusted to reflect nonperformance risk of both the counterparty and the Company.

Warehouse Notes Payable Consist of borrowings outstanding under warehouse line agreements. The borrowing rates on the warehouse lines are based upon average 30-day LIBOR plus an applicable margin. The carrying amounts approximate fair value because of the short maturity of these instruments (Level 1).

Notes Payable Consist of borrowings outstanding under term note agreements. The borrowing rates on the notes payable are based upon average 30-day LIBOR plus an applicable margin. The Company estimates the fair value by discounting the future cash flows of each instrument at market rates (Level 2).

Fair Value of Derivative Instruments and Loans Held for Sale In the normal course of business, the Company enters into contractual commitments to originate (purchase) and sell multifamily mortgage loans at fixed prices with fixed expiration dates. The commitments become effective when the borrowers lock-in a specified interest rate within time frames established by the Company. All mortgagors are evaluated for creditworthiness prior to the extension of the commitment. Market risk arises if interest rates move adversely between the time of the lock-in of rates by the borrower and the sale date of the loan to an investor.

To mitigate the effect of the interest rate risk inherent in providing rate lock commitments to borrowers, the Company s policy is to enter into a sale commitment with the investor simultaneously with the rate lock commitment with the borrower. The sale contract

with the investor locks in an interest rate and price for the sale of the loan. The terms of the contract with the investor and the rate lock with the borrower are matched in substantially all respects, with the objective of eliminating interest rate risk to the extent practical. Sale commitments with the investors have an expiration date that is longer than our related commitments to the borrower to allow, among other things, for the closing of the loan and processing of paperwork to deliver the loan into the sale commitment.

Both the rate lock commitments to borrowers and the forward sale contracts to buyers are undesignated derivatives and, accordingly, are marked to fair value through the gains on mortgage banking activities line item in the Condensed Consolidated Statements of Income. The fair value of the Company s rate lock commitments to borrowers and loans held for sale and the related input levels includes, as applicable:

- the assumed gain/loss of the expected resultant loan sale to the buyer;
- the expected net future cash flows associated with servicing the loan (Level 2);
- the effects of interest rate movements between the date of the rate lock and the balance sheet date (Level 2); and
- the nonperformance risk of both the counterparty and the Company (Level 3).

The fair value of the Company s forward sales contracts to investors considers effects of interest rate movements between the trade date and the balance sheet date (Level 2). The market price changes are multiplied by the notional amount of the forward sales contracts to measure the fair value.

The assumed gain/loss considers the amount that the Company has discounted the price to the borrower from par for competitive reasons, if at all, and the expected net cash flows from servicing to be received upon securitization of the loan. The fair value of the expected net future cash flows associated with servicing the loan is calculated pursuant to the valuation techniques described previously for mortgage servicing rights.

To calculate the effects of interest rate movements, the Company uses applicable published U.S. Treasury prices, and multiplies the price movement between the rate lock date and the balance sheet date by the notional loan commitment amount.

The fair value of the Company s forward sales contracts to investors considers the market price movement of the same type of security between the trade date and the balance sheet date (Level 2). The market price changes are multiplied by the notional amount of the forward sales contracts to measure the fair value.

The fair value of the Company s interest rate lock commitments and forward sales contracts is adjusted to reflect the risk that the agreement will not be fulfilled. The Company s exposure to nonperformance in rate lock and forward sale contracts is represented by the contractual amount of those instruments. Given the credit quality of our counterparties, the short duration of interest rate lock commitments and forward sale contracts, and the Company s historical experience with the agreements, the risk of nonperformance by the Company s counterparties is not significant.

		Fair Value Adjustment Components			Balance Sheet Location		
(in thousands)	Notional or Principal Amount	Assumed Gain (Loss) on Sale	Interest Rate Movement Effect	Total Fair Value Adjustment	Derivative Assets	Derivative Liabilities	Fair Value Adjustment To Loans Held for Sale
March 31, 2013							
Rate lock commitments	$ 168,130	$ 6,298	$ 1,635	$ 7,933	$ 7,933	$	$
Forward sale contracts	637,243		(3,459)	(3,459)	373	(3,936)	
Loans held for sale	469,113	8,842	1,824	10,666			10,666
Total		$ 15,140	$	$ 15,140	$ 8,306	$ (3,936)	$ 10,666
December 31, 2012							
Rate lock commitments	$ 302,373	$ 11,953	$ (1,194)	$ 10,759	$ 10,759	$	$
Forward sale contracts	1,380,235		9,756	9,756	10,499	(867)	
Loans held for sale	1,077,862	32,261	(8,562)	23,699			23,699
Total		$ 44,214	$	$ 44,214	$ 21,258	$ (867)	$ 23,699

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NOTE 10 LITIGATION, COMMITMENTS, AND CONTINGENCIES

Fannie Mae DUS Related Commitments Commitments for the origination and subsequent sale and delivery of loans to Fannie Mae represent those mortgage loan transactions where the borrower has locked an interest rate and scheduled closing and the Company has entered into a mandatory delivery commitment to sell the loan to Fannie Mae. As discussed in Note 9, the Company accounts for these commitments as derivatives recorded at fair value.

The Company is generally required to share the risk of any losses associated with loans sold under the Fannie Mae DUS program (the DUS risk-sharing obligations). The Company is required to secure this obligation by assigning restricted cash balances and securities to Fannie Mae. On March 29, 2013 Fannie Mae announced changes to the DUS Capital Standards that are retroactive to January 1, 2013. These changes, and the impact on the Company, are as follows:

- Restricted liquidity requirements for Tier 1 loans were increased from 90 basis points to 110 basis points. The increased reserve requirement must be met immediately. The Company currently has an insignificant number of Tier 1 loans in our portfolio which will be affected by the announced collateral changes, and does not expect it will have a material impact on the Company s future operations;

- Restricted liquidity requirements for existing Tier 2 loans were increased from 60 basis points to 75 basis points. The restricted liquidity requirement on new Tier 2 loans will continue to be funded over a 48 month period that begins upon delivery of the loan to Fannie Mae. The restricted liquidity requirement on existing Tier 2 mortgage loans will increase gradually (from 51 basis points as of December 31, 2012) by three basis points per quarter for eight quarters through December 31, 2014. As of March 31, 2013, the increased reserve requirement for existing Tier 2 loans from 51 basis points to 75 basis points on Tier 2 loans requires the Company to fund $49.9 million in additional restricted liquidity over the eight quarters beginning with March 31, 2013, or $6.2 million per quarter.

- Restricted liquidity held as collateral in the form of US Treasuries will experience a collateral reduction increasing from 0% to 3%, the discount on US Federal Agency Securities will increase from 3% to 4%, and the discount on money market funds holding US Treasuries will increase from 0% to 5%. As of March 31, 2013, the Company held all of its restricted liquidity in money market funds holding US Treasuries.

As a result of these changes, the Company was required to fund an additional $1.9 million of restricted reserves to satisfy the new requirements established by Fannie Mae. As of April 30, 2013, the Company has funded the additional restricted liquidity in order to satisfy its obligations with respect to the DUS Capital Standards. Fannie Mae will reassess the DUS Capital Standards on or before June 30, 2014. The Company generates sufficient cash flow from its operations to meet these new capital standards and does not expect these changes to have a material impact on its future operations; however, future changes to collateral requirements may adversely impact the Company.

Under the provisions of the DUS agreement, the Company must also maintain a certain level of liquid assets referred to as the operational and unrestricted portions of the required reserves each year. These requirements were satisfied by the Company as of March 31, 2013.

Fannie Mae has established benchmark standards for capital adequacy, and reserves the right to terminate the Company s servicing authority for all or some of the portfolio, if at any time it determines that the Company s financial condition is not adequate to support its obligation under the DUS agreement. The Company is required to maintain acceptable net worth as defined in the agreement, and the Company satisfied the requirements as of March 31, 2013. The net worth requirement is derived primarily from unpaid balances on Fannie Mae loans and the level of risk-sharing. At March 31, 2013, the net worth requirement was $86.9 million and the Company s net worth was $190.1 million, as defined. As of March 31, 2013, the Company was required to maintain at least $16.1 million of liquid assets to meet our operational liquidity requirements, as defined in the agreements, for Fannie Mae, Freddie Mac, HUD and Ginnie Mae. As of March 31, 2013, the Company had operational liquidity of $62.7 million.

Litigation Capital Funding litigation On February 17, 2010, Capital Funding Group, Inc. (Capital Funding) filed a lawsuit in the state Circuit Court of Montgomery County, Maryland against Walker & Dunlop, LLC, our wholly owned subsidiary, for alleged breach of contract, unjust enrichment and unfair competition arising out of an alleged agreement that Capital Funding had with Column Guaranteed, LLC (Column) to refinance a large portfolio of senior healthcare facilities located throughout the United States (the Golden Living Facilities). Capital Funding alleges that a contract existed between it and Column (and its affiliates) whereby Capital Funding allegedly had the right to perform the HUD refinancing for the Golden Living Facilities and according to which Capital Funding provided certain alleged proprietary information to Column and its affiliates relating to the refinancing of the Golden Living Facilities on a confidential basis. Capital Funding further alleges that Walker & Dunlop, LLC, as the alleged successor by merger to Column, is bound by Column s alleged agreement with Capital Funding, and breached the agreement by taking for itself the opportunity to perform the HUD refinancing for the Golden Living Facilities.

Capital Funding further claims that Column and its affiliates and Walker & Dunlop, LLC breached the contract, were unjustly enriched, and committed unfair competition by using Capital Funding s alleged proprietary information for certain allegedly

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unauthorized purposes. Capital Funding also asserts a separate unfair competition claim against Walker & Dunlop, LLC in which it alleges that Walker & Dunlop, LLC is improperly taking credit on its website for certain work actually performed by Capital Funding. Capital Funding seeks damages in excess of $30 million on each of the three claims asserted against all defendants, and an unspecified amount of damages on the separate claim for unfair competition against Walker & Dunlop, LLC. Capital Funding also seeks injunctive relief in connection with its unjust enrichment and unfair competition claims.

Pursuant to an agreement, dated January 30, 2009 (the Column Transaction Agreement), among Column, Walker & Dunlop, LLC, W&D, Inc. and Green Park, Column generally agreed to indemnify Walker & Dunlop, LLC against liability arising from Column s conduct prior to Column s transfer of the assets to Walker & Dunlop, LLC. However, pursuant to the Column Transaction Agreement, Column s indemnification obligation arises only after Column receives a claim notice following the resolution of the litigation that specifies the amount of Walker & Dunlop, LLC s claim.

To provide for greater certainty regarding Column s indemnification obligations before the resolution of this litigation and to cap our total loss exposure, the Company secured a further agreement from Column in November 2010 confirming that it will indemnify the Company for any liabilities that arise as a result of this litigation. As part of this further indemnification agreement, in the event Column is required to pay the Company for any liabilities under the Capital Funding litigation that it otherwise would not have been obligated to pay under the Column Transaction Agreement, the Company will indemnify Column for an amount up to $3.0 million. Also as part of this further indemnification agreement, William Walker, our Chairman, President and Chief Executive Officer, and Mallory Walker, former Chairman and current stockholder, in their individual capacities, agreed that if Column is required to indemnify the Company under this agreement and otherwise would not have been obligated to pay such amounts under the Column Transaction Agreement, Messrs. William Walker and Mallory Walker will pay any such amounts in excess of $3.0 million but equal to or less than $6.0 million. As a result of this agreement, the Company will have no liability or other obligation for any damage amounts in excess of $3.0 million arising out of this litigation. Although Column has assumed defense of the case for all defendants, and is paying applicable counsel fees, as a result of the indemnification claim procedures described above, the Company could be required to bear the significant costs of the litigation and any adverse judgment unless and until the Company is able to prevail on our indemnification claim. The Company believes that it will fully prevail on its indemnification claims against Column, and that the Company ultimately will incur no material loss as a result of this litigation, although there can be no assurance that this will be the case. Accordingly, we have not recorded a loss contingency for this litigation.

On July 19, 2011, the Circuit Court for Montgomery County, Maryland issued an order granting the defendants motion to dismiss the case; without prejudice. After the initial case was dismissed without prejudice, Capital Funding filed an amended complaint. In November 2011, the Circuit Court of Montgomery County rejected the Company s motion to dismiss the amended complaint. Capital Funding filed a Second Amended Complaint that did not alter the claims at issue but revised their alleged damages. Defendants moved for summary judgment on all claims, including two counts of breach of contract, two counts of promissory estoppel, two counts of unjust enrichment, and two counts of unfair competition. On April 30, 2013, the Court issued an Opinion and Order which granted the motion as to the promissory estoppel counts and one count of unjust enrichment. The court denied the motion as to all remaining claims. Fact discovery in the case has concluded, and a trial is scheduled to begin on the remaining claims on July 8, 2013.

As a result of the indemnification listed above, the Company s loss exposure is limited to $3.0 million.

The Company cannot predict the outcome of any pending litigation and may be subject to consequences that could include fines, penalties and other costs, and our reputation and business may be impacted. The Company s management believes that any liability that could be imposed on the Company in connection with the disposition of any pending lawsuits would not have a material adverse effect on our business, results of operations, liquidity or financial condition.

In the normal course of business, the Company may be party to various claims and litigation, none of which the Company believes is material.

NOTE 11 EARNINGS PER SHARE

The following weighted average shares and share equivalents are used to calculate basic and diluted earnings per share for the three months ended March 31, 2013 and 2012:

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	For the three months ended March 31,	
	2013	2012
Weighted average number of shares outstanding used to calculate basic earnings per share	33,570,130	21,750,573
Dilutive securities		
Unvested restricted shares	586,630	97,707
Weighted average number of shares and share equivaltents outstanding used to calculate diluted earnings per share	34,156,760	21,848,280

The assumed proceeds used in the treasury method used for calculating the dilutive impact of restricted stock awards includes the unrecognized compensation costs and excess tax benefits associated with the awards. Options issued under the 2010 Equity Incentive Plan to purchase 7,375 and 122,493 shares of common stock were outstanding during the three months ended March 31, 2013 and 2012, respectively, but were not included in the computation of diluted earnings per share because the effect would have been anti-dilutive.

NOTE 12 STOCKHOLDERS EQUITY

A summary of changes in stockholders equity is presented below (dollars in thousands):

	Common Stock		Additional Paid-In Capital	Retained Earnings	Total Stockholders Equity
	Shares	Amount			
Balances at December 31, 2012	33,567,730	$ 336	$ 236,823	$ 116,017	$ 353,176
Net income				7,726	7,726
Issuance of common shares in connection with equity incentive plans	62,151		119		119
Repurchase and retirement of common stock	(16,049)		(292)		(292)
Stock-based compensation			2,160		2,160
Tax benefit from vesting of restricted shares			161		161
Balances at March 31, 2013	33,613,832	$ 336	$ 238,971	$ 123,743	$ 363,050

NOTE 13 TRANSACTIONS WITH RELATED PARTIES

As of March 31, 2013, Credit Suisse Securities (USA) LLC, through its ownership of Column, owns a 10% interest in the Company. From time to time, Credit Suisse refers HUD related financing opportunities to the Company, for which it receives fees. For the three months ended March 31, 2013 and 2012, Credit Suisse had earned zero and $0.8 million, respectively, of fees for the referral of HUD transactions to the Company (co-broker fees). At March 31, 2013, the Company had accrued $0.1 million of co-broker fees payable to Credit Suisse.

On February 9, 2012, the Company entered into an amendment to the agreement regarding the allocation of origination fees and trade premiums generated by certain transactions between Credit Suisse and the Company and providing for other terms and conditions with respect to future

loan origination opportunities. The amendment resulted in a $2.5 million reduction in the amount the Company owed to Credit Suisse at December 31, 2011, which was recognized as other revenues during the three months ended March 31, 2012.

A third party entity, Walker & Dunlop Multifamily Equity I, LLC (the Managing Member), in which Mr. Walker and other individuals hold ownership, is the managing member of an investment fund. The Company provides consulting and related services to

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the Managing Member pursuant to a corporate services agreement for a fee which approximates our cost for such services. The amount of such fees was $0.1 million and $0.2 million for the three months ended March 31, 2013 and 2012.

NOTE 14 SUBSEQUENT EVENTS

On April 11, 2013, the Company executed an amendment to its lease agreement for the Needham, MA office. The amendment, among other things, modified the leasable space of the office and required the payment of a modification fee. The leasable space was amended from 40,066 square feet through June 30, 2022 to (i) 45,955 square feet from the period January 1, 2013 to March 31, 2013, (ii) 44,825 square feet from the period April 1, 2013 to June 30, 2013, and (iii) 19,368 square feet from the period July 1, 2013 to June 30, 2023. In connection with the amendment, the Company incurred a modification fee of $0.8 million, which was charged to expense in the second quarter of 2013.

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

The following discussion should be read in conjunction with the historical financial statements and the related notes thereto included elsewhere in this Quarterly Report on Form 10-Q. The following discussion contains, in addition to historical information, forward-looking statements that include risks and uncertainties. Our actual results may differ materially from those expressed or contemplated in those forward looking statements as a result of certain factors, including those set forth under the headings Forward-Looking Statements and Risk Factors elsewhere in this Quarterly Report on Form 10-Q.

Forward-Looking Statements

Some of the statements in this quarterly report on Form 10-Q of Walker & Dunlop, Inc. and subsidiaries (the Company, Walker & Dunlop, we, us), may constitute forward-looking statements within the meaning of the federal securities laws. Forward-looking statements relate to expectations, projections, plans and strategies, anticipated events or trends and similar expressions concerning matters that are not historical facts. In some cases, you can identify forward-looking statements by the use of forward-looking terminology such as may, will, should, expects, intends, plans, anticipates, believes, estimates, predicts, or potential or the negative of these words and phrases or similar words or phr are predictions of or indicate future events or trends and which do not relate solely to historical matters. You can also identify forward-looking statements by discussions of strategy, plans or intentions.

The forward-looking statements contained in this Form 10-Q reflect our current views about future events and are subject to numerous known and unknown risks, uncertainties, assumptions and changes in circumstances that may cause actual results to differ significantly from those expressed or contemplated in any forward-looking statement. Statements regarding the following subjects, among others, may be forward-looking:

- the future of the GSEs and their impact on our business;
- the future funding level of HUD, including whether such funding will be sufficient to support future firm commitment requests, and its impact on our business;
- our growth strategy;
- our projected financial condition, liquidity and results of operations;
- our ability to obtain and maintain warehouse and other loan funding arrangements;
- availability of and our ability to retain qualified personnel and our ability to develop relationships with borrowers, key principals and lenders;
- degree and nature of our competition;
- the outcome of pending litigation;

- changes in governmental regulations and policies, tax laws and rates, and similar matters and the impact of such regulations, policies and actions;
- our ability to comply with the laws, rules and regulations applicable to us;
- trends in the commercial real estate finance market, interest rates, commercial real estate values, the credit and capital markets or the general economy; and
- general volatility of the capital markets and the market price of our common stock.

While forward-looking statements reflect our good faith projections, assumptions and expectations, they are not guarantees of future results. Furthermore, we disclaim any obligation to publicly update or revise any forward-looking statement to reflect changes in underlying assumptions or factors, new information, data or methods, future events or other changes, except as required by applicable law. For a further discussion of these and other factors that could cause future results to differ materially from those expressed or contemplated in any forward-looking statements, see Risk Factors.

Business

We are one of the leading commercial real estate finance companies in the United States, with a primary focus on multifamily lending. We originate, sell and service a range of multifamily and other commercial real estate financing products. Our clients are owners and developers of commercial real estate across the country. We originate and sell loans through the programs of Fannie Mae, Freddie Mac, Ginnie Mae, and the Federal Housing Administration, a division of the U.S. Department of Housing and Urban Development, with which we have long-established relationships. We retain servicing rights and asset management responsibilities on nearly all loans that we originate for GSE and HUD programs. We are approved as a Fannie Mae Delegated Underwriting and Servicing (DUS) lender nationally, a Freddie Mac Program Plus lender in 22 states and the District of Columbia, a HUD Multifamily Accelerated Processing (MAP) lender nationally, a HUD LEAN lender nationally, and a Ginnie Mae issuer. We also originate and service loans for a number of life insurance companies, commercial banks and other institutional investors, in which cases we do not fund the loan but rather act as a loan broker. Additionally, through our subsidiary entities, we provide institutional advisory, asset management, and investment management services specializing in debt, structured debt, and equity financing for commercial real estate.

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We fund loans for GSE and HUD programs, generally through warehouse facility financings, and sell them to investors in accordance with the related loan sale commitment, which we obtain prior to loan closing. Proceeds from the sale of the loan are used to pay off the warehouse facility. The sale of the loan is typically completed within 60 days after the loan is closed. In cases where we do not fund the loan, we act as a loan broker and service some of the loans. Our originators who focus on loan brokerage are engaged by borrowers to work with a variety of institutional lenders to find the most appropriate loan instrument for the borrowers needs. These loans are then funded directly by the institutional lender and we receive an origination fee for placing the loan and a servicing fee for any loans we service.

We recognize gains from mortgage banking activities when we commit to both make a loan to a borrower and sell that loan to an investor. The gains from mortgage banking activities reflect the fair value attributable to loan origination fees, premiums or losses on the sale of loans, net of any co-broker fees, and the fair value of the expected net future cash flows associated with the servicing of loans, net of any guaranty obligations retained. We also generate revenue from net warehouse interest income we earn while the loan is held for sale in one of our warehouse facilities.

We retain servicing rights on substantially all of the loans we originate and sell, and generate revenues from the fees we receive for servicing the loans, interest income from escrow deposits held on behalf of borrowers, late charges and other ancillary fees. Servicing fees are set at the time an investor agrees to purchase the loan and are generally paid monthly for the duration of the loan. Our Fannie Mae and Freddie Mac servicing arrangements generally provide for prepayment penalties to the Company in the event of a voluntary prepayment. For loans serviced outside of Fannie Mae and Freddie Mac, we typically do not share in any such payments.

We are currently not exposed to interest rate risk during the loan commitment, closing and delivery process. The sale or placement of each loan to an investor is negotiated prior to establishing the coupon rate for the loan. We also seek to mitigate the risk of a loan not closing. We have agreements in place with the GSEs and HUD that specify the cost of a failed loan delivery, also known as a pair off fee, in the event we fail to deliver the loan to the investor. The pair off fee is typically less than the deposit we collect from the borrower. Any potential loss from a catastrophic change in the property condition while the loan is held for sale using warehouse facility financing is mitigated through property insurance equal to replacement cost. We are also protected contractually from any failure to close by an investor. We have experienced only one failed delivery in our history and did not incur any loss.

We have risk-sharing obligations on most loans we originate under the Fannie Mae DUS program. When a Fannie Mae DUS loan is subject to full risk-sharing, we absorb losses on the first 5% of the unpaid principal balance of a loan, and above 5% we share a percentage of the loss with Fannie Mae, with our maximum loss capped at 20% of the unpaid principal balance of a loan (subject to doubling or tripling if the loan does not meet specific underwriting criteria or if the loan defaults within 12 months of its sale to Fannie Mae). We may, however, request modified risk-sharing at the time of origination, which reduces our potential risk-sharing losses from the levels described above. We regularly request modified risk-sharing based on such factors as the size of the loan, market conditions and loan pricing. We may also request modified risk-sharing on large transactions if we do not believe that we are being fully compensated for the risks of the transactions or to manage overall risk levels. Our current credit management policy is to cap each loan balance subject to full risk-sharing at $60 million. Accordingly, we currently elect to use modified risk-sharing for loans of more than $60 million in order to limit our maximum loss exposure on any one loan to $12 million (such exposure would occur in the event that the underlying collateral is determined to be completely without value at the time of loss). However, we may on occasion elect to originate a loan with full risk sharing even when the loan balance is greater than $60 million if we believe the loan characteristics support such an approach.

Our servicing fees for risk-sharing loans include compensation for the risk-sharing obligations and are larger than the servicing fees we receive from Fannie Mae for loans with no risk-sharing obligations. We receive a lower servicing fee for modified risk-sharing than for full risk-sharing.

We offer an interim loan program offering floating-rate debt, for terms of up to two years, to experienced borrowers seeking to acquire or reposition multifamily properties that do not currently qualify for permanent financing (the Program). We closed our first loans under the Program in 2012. We underwrite all loans originated through the Program. During the time that they are outstanding, we assume the full risk of loss on the loans. In addition, we service and asset-manage loans originated through the Program, with the ultimate goal of providing permanent financing on the properties.

On September 4, 2012, we closed our acquisition of CWCapital, LLC (CWCapital), at which time the total consideration transferred was valued at approximately $231.1 million, consisting of $80.0 million in cash and our issuance in a private placement to CW Financial Services, LLC (CW Financial) of approximately 11.6 million shares of common stock valued at approximately $151.1 million (the Acquisition). CWCapital, a Massachusetts limited liability company, was one of the leading commercial real estate finance companies in the United States, with a primary focus on multifamily lending, originating and selling mortgage loans pursuant to the programs of Fannie Mae, Freddie Mac, Ginnie Mae and HUD. The Acquisition combined two of the leading commercial real estate lenders in the country to form one of the largest commercial real estate lenders in the country.

Basis of Presentation

The accompanying condensed consolidated financial statements include all of the accounts of the Company and its wholly owned

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subsidiaries, and all material intercompany transactions have been eliminated.

Critical Accounting Policies

Our condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America, which require management to make estimates and assumptions that affect reported amounts. The estimates and assumptions are based on historical experience and other factors management believes to be reasonable. Actual results may differ from those estimates and assumptions. We believe the following critical accounting policies represent the areas where more significant judgments and estimates are used in the preparation of our condensed consolidated financial statements.

Mortgage Servicing Rights and Guaranty Obligations. MSRs are recorded at fair value the day we sell a loan. We only recognize MSRs for GSE and HUD originations. Our servicing contracts with non-governmental originations are cancelable with limited notice and as a result, have a de minimis fair value. The fair value is based on the expected future net cash flows associated with the servicing rights. The expected net cash flows are discounted at a rate that reflects the credit and liquidity risk of the MSR over the estimated life of the underlying loan.

In addition to the MSR, for all Fannie Mae DUS loans with risk-sharing obligations, upon sale we record the fair value of the obligation to stand ready to perform over the term of the guaranty (non-contingent obligation), and the fair value of the expected loss from the risk-sharing obligations in the event of a borrower default (contingent obligation). In determining the fair value of the guaranty obligation, we consider the risk profile of the collateral, historical loss experience, and various market indicators. Generally, the estimated fair value of the guaranty obligation is based on the present value of the future cash flows expected to be paid under the guaranty over the life of the loan (historically three to five basis points annually), discounted using a 12-15 percent discount rate. Historically, the contingent obligation recognized has been de minimis. The estimated life and discount rate used to calculate the guaranty obligation are consistent with those used to calculate the corresponding MSR.

The MSR and associated guaranty obligation are amortized into expense over the estimated life of the loan. The MSR is amortized in proportion to, and over the period, that net servicing income is expected to be received. The guaranty obligation is amortized evenly over the term of the loan. If a loan defaults and is not expected to become current or pays off prior to the estimated life, the net unamortized MSR and guaranty obligation balances are expensed.

We carry the MSRs at the lower of amortized value or fair market value and evaluate the carrying value quarterly. We engage a third party to assist in valuing our MSRs on a semi-annual basis.

Allowance for Risk-Sharing Obligations. The amount of the allowance considers our assessment of the likelihood of payment by the borrower or key principal(s), the estimated disposition value of the underlying collateral and the level of risk-sharing. Historically, initial loss recognition occurs at or before the loan becoming 60 days delinquent. We regularly monitor our risk-sharing obligations on all loans and update loss estimates as current information is received.

Goodwill. Business combinations are accounted for using the acquisition method of accounting, under which the purchase price of the acquisition is allocated to the assets acquired and liabilities assumed using the fair values determined by management as of the acquisition date. We recognize identifiable assets acquired and liabilities assumed (both specific and contingent) at their fair values at the acquisition date. Furthermore, acquisition-related costs, such as due diligence, legal and accounting fees, are not capitalized or applied in determining the fair value of the acquired assets.

We do not amortize goodwill; instead, we evaluate goodwill for impairment at least annually. In addition to our annual impairment evaluation, we evaluate whether events or circumstances have occurred in the period subsequent to our annual impairment testing which indicate that it is more likely than not an impairment loss has occurred.

Intangible Assets. We evaluate our identified intangibles for impairment annually or if other events or circumstances indicate that the carrying value may be impaired.

Overview of Current Business Environment

In 2013, U.S. multifamily market fundamentals have continued their improvement following the macroeconomic instability experienced in recent years. Occupancy rates and effective rents appear to have increased based upon increased rental market demand, both of which aid loan performance due to their importance to the cash flows of the underlying properties. Additionally, many commercial real estate properties are projected to need refinancing in the coming years.

The passage of Dodd-Frank introduced complex, comprehensive legislation into the financial and real estate recoveries, which will have far reaching effects on the industry and its participants. While we are not a banking institution, there is uncertainty as to how, in the coming years, Dodd-Frank may affect us or our competitors.

The scope, extent and timing of GSE reform continue to be uncertain. Although we cannot predict what actions Congress or other

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governmental agencies may take affecting the GSEs and/or HUD, we expect some regulatory change is likely. In March 2013, the GSEs regulator, the Federal Housing Finance Agency, communicated a goal to reduce multifamily origination volumes 10 percent from 2012 levels. Additionally, in April 2013, HUD announced that the allocation from the Federal government to fund multifamily originations may be insufficient to meet all requests through the end of its fiscal year (September 30, 2013) if volumes for the first half of its fiscal year continued through the second half of the fiscal year. In spite of these communications from the GSEs and HUD, we believe that the GSEs and HUD will continue to supply a sufficient level of capital to the multifamily market. As noted in our Annual Report on Form 10-K for the year ended December 31, 2012 (2012 Form 10-K), we continue to explore channels to diversify our revenue streams to limit the impact of such events on our ability to do business and meet our customers needs.

Results of Operations

Following is a discussion of our results of operations for the three months ended March 31, 2013 and 2012. The financial results are not necessarily indicative of future results. Our quarterly results have fluctuated in the past and are expected to fluctuate in the future, reflecting the interest rate environment, the volume of transactions, and general economic conditions. Additionally, the results of operations for the three months ended March 31, 2013 reflect the impact of the Acquisition, which materially affects the comparability to the prior year. Please refer to the table below, which provides supplemental data regarding our financial performance.

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(Dollars in thousands)	For the three months ended March 31, 2013	2012
Origination Data:		
Origination Volumes by Investor		
Fannie Mae	$ 762,973	$ 267,901
Freddie Mac	514,595	84,517
Ginnie Mae - HUD	147,433	112,603
Other (1)	306,351	209,435
Total	$ 1,731,352	$ 674,456
Key Metrics (as a percentage of total revenues):		
Personnel expenses	41%	34%
Other operating expenses	13%	13%
Total expenses	82%	72%
Adjusted total expenses (2)	80%	72%
Operating margin	18%	28%
Adjusted operating margin (2)	20%	28%
Key Origination Metrics (as a percentage of origination volume):		
Origination related fees	1.29%	1.52%
Fair value of MSRs created, net	1.19%	1.41%
Fair value of MSRs created, net as a percentage of GSE and HUD origination volume (3)	1.45%	2.05%

	As of March 31, 2013	2012
Servicing Portfolio by Type:		
Fannie Mae	$ 19,259,656	$ 10,277,105
Freddie Mac	9,602,557	3,200,241
Ginnie Mae - HUD	4,630,452	1,478,202