



Arbor Realty Trust, Inc.



Solutions custom-made

2004 ANNUAL REPORT

FINANCIAL HIGHLIGHTS

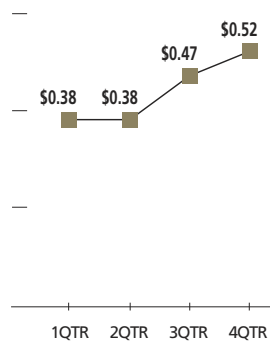
	Year Ended December 31, 2004	Period from June 24, 2003 (Inception) to December 31, 2003
Consolidated Income Statement Data:		
Interest income	\$ 57,927,230	\$ 10,012,449
Other income	42,265	156,502
Total revenue	57,969,495	10,168,951
Management fees—related party	3,614,830	587,734
Total expenses	27,545,997	5,452,865
Net income	25,072,682	3,407,919
Earnings per share, basic	1.81	0.42
Earnings per share, diluted ⁽¹⁾⁽²⁾	1.78	0.42
Dividends declared per common share ⁽³⁾	1.16	0.50
	At December 31, 2004	At December 31, 2003
Consolidated Balance Sheet Data		
Loans and investments, net	\$831,783,364	\$286,036,610
Related party loans, net	7,749,538	35,940,881
Total assets	912,295,177	338,164,432
Repurchase agreements	409,109,372	113,897,845
Notes payable	165,771,447	58,630,626
Total liabilities	589,292,273	183,416,716
Minority interest	60,249,731	43,631,602
Total stockholders' equity	262,753,173	111,116,114
	Year Ended December 31, 2004	Period from June 24, 2003 (Inception) to December 31, 2003
Other Data		
Total originations	\$782,301,133	\$186,289,922

(1) As of December 31, 2004, ACM, our manager, earned incentive management fees totaling \$1.6 million. Based on the terms of the management agreement, ACM elected to be paid its incentive management fee in common shares totaling 66,141. These shares were anti-dilutive and have been excluded from the calculation of diluted earnings per share.

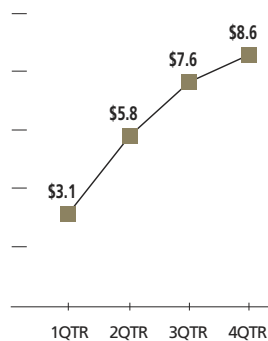
(2) The warrants underlying the units issued in the private placement at \$75.00 per unit have an initial exercise price of \$15.00 per share and expire on July 1, 2005. This exercise price is equal to the price per share of common stock underlying the units and approximates the market value of our common stock at December 31, 2003. Therefore, the assumed exercise of the warrants was not considered to be dilutive for purposes of calculating diluted earnings per share.

(3) On January 13, 2005 our board of directors authorized and we declared a distribution to our stockholders of \$0.47 per share of common stock, payable with respect to the quarter ended December 31, 2004, to stockholders of record at the close of business on January 31, 2005. We made this distribution on February 15, 2005.

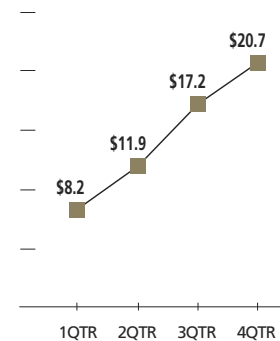
**Earnings Per
Common Share**
(Diluted in Dollars)

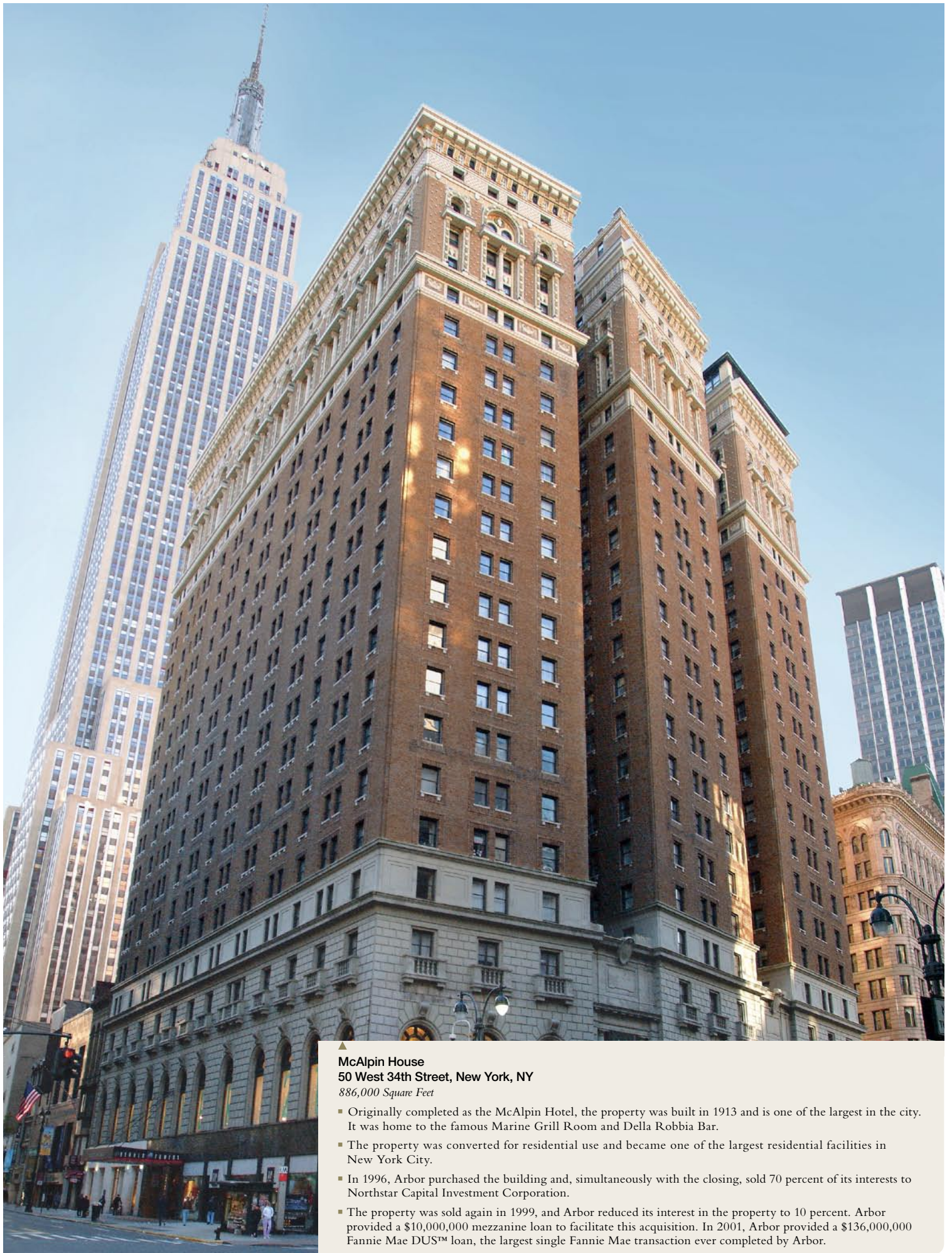


Net Income
(Dollars in Millions)



Total Revenue
(Dollars in Millions)





▲
McAlpin House
50 West 34th Street, New York, NY
886,000 Square Feet

- Originally completed as the McAlpin Hotel, the property was built in 1913 and is one of the largest in the city. It was home to the famous Marine Grill Room and Della Robbia Bar.
- The property was converted for residential use and became one of the largest residential facilities in New York City.
- In 1996, Arbor purchased the building and, simultaneously with the closing, sold 70 percent of its interests to Northstar Capital Investment Corporation.
- The property was sold again in 1999, and Arbor reduced its interest in the property to 10 percent. Arbor provided a \$10,000,000 mezzanine loan to facilitate this acquisition. In 2001, Arbor provided a \$136,000,000 Fannie Mae DUS™ loan, the largest single Fannie Mae transaction ever completed by Arbor.

To Our Shareholders,



In 2004, Arbor Realty Trust experienced a very exciting and rewarding year as we delivered exceptional returns to our shareholders. Our diverse portfolio of assets, excellent financial results and expanded finance facilities are indicative of the great progress we have made in building a premier real estate finance investment franchise. Our first priority has been and always will be to maximize shareholder value. So it is with great pride and enthusiasm that we present the outstanding results of 2004 and our ambitions for the future.

Arbor was extremely successful in deploying the capital raised during the initial public offering in April of 2004. As a result, the Company experienced little dilution, allowing us to achieve very strong earnings growth on a quarter-to-quarter basis. This resulted in a total net income for the year ended December 31, 2004 of \$25.1 million, or \$1.78 per diluted common share.

One of our competitive advantages is our ability to participate in every aspect of the capital structure of a real estate transaction, including structuring and controlling both the equity and debt components. This flexibility becomes more valuable in the increasingly competitive real estate finance market. We benefit from our ability to evaluate the risk-adjusted return for each component of a potential transaction, retaining those pieces that best satisfy our investment criteria and disposing of those that do not.

Our strong growth in earnings enabled us to deliver a solid quarterly cash dividend. In fact, we attained two dividend increases throughout the year. During the year, we originated 53 loans and investments totaling \$782 million. This represents an average transaction size of almost \$15 million, nearly double the average loan size in the portfolio when we began operations. Although excess liquidity in the capital markets resulted in accelerated prepayments of loans in our

portfolio, we have been successful in replenishing this runoff. Our pipeline remains strong, and we are well-positioned for 2005. Looking ahead, we remain confident in our ongoing ability to originate longer-term transactions and obtain prepayment protection whenever possible, generating growth that is consistent with our business model.

In addition to delivering growth and consistency in our dividend, we have also been able to add equity participation interests, or equity kickers, as an ongoing part of our business strategy. We have originated a total of six transactions with this feature. In the latter half of the year, we received our first distribution from one of these investments. Although equity kickers require time to harvest, we anticipate the distributions will contribute to our bottom line in 2005 and beyond, thus fueling long-term growth and further enhancing the value of our franchise.

One of the highlights of 2004 was the completion of our first collateralized debt obligation (CDO). This innovative structure lowers our borrowing cost, frees up capacity in our warehouse facilities, provides longer-term financing and allows us to offer fixed rate product. We have created a vehicle to securitize our assets, and as we grow our portfolio, we will continue to explore accessing the securitization markets to capitalize on the competitive advantages this unique structure

Arbor Realty Trust celebrates the grand opening of its New York City office by ringing the closing bell at the New York Stock Exchange on November 9, 2004.



affords us. The CDO is a key component of the great progress we have made in diversifying our funding sources. In addition to the CDO, we have added several new debt facilities that greatly enhance our flexibility in funding new assets.

We will continue to maintain sensitivity to the evolving market conditions. Real estate values and liquidity are at historically high levels. Our ability to participate in all aspects of real estate finance will create unique opportunities in this environment. Given the health and stability of our portfolio, we will remain extremely selective in our transactions. We will not make any investments, nor will we raise additional capital, merely for the sake of growing the portfolio; rather, transactions will only close when they satisfy all of our strategic objectives.

Arbor provides a versatile product line customized to each client's distinct needs. We will continue to approach each and every borrower's requirements with the personal customization that has helped us gain our success. These unique and flexible characteristics have allowed us to build our business by establishing long-term relationships with customers—75% of Arbor's business comes from repeat borrowers.

As I have always said, one of the greatest strengths of our firm is the depth and expertise of our management team. In 2004, we made significant additions to key management positions, further strengthening the Company's overall talent and leadership. There is now incredible expertise across all segments of Arbor's business, and we look forward to capitalizing on our team's knowledge and experience to help lead us in the future.

I would like to take a moment to thank everyone who has helped guide Arbor through this pivotal and successful year. I want to commend Arbor's management team and employees

for their commitment and dedication. I would also like to thank our Board of Directors for their guidance. And, of course, I wish to extend a special recognition and thanks to you, our shareholders, for your continued support.

While we achieved strong financial results in 2004, we further cemented our foundation for delivering long-term returns. We expanded and strengthened our portfolio, enhanced client relationships, maintained excellent credit quality and solidified our brand reputation within the commercial real estate finance market. We are proud of our past accomplishments, but more importantly, we are committed to delivering results and increasing shareholder value in 2005 and beyond. With ongoing dedication and perseverance, we are confident we can deliver an even stronger performance in the future.

Regards,

Ivan Kaufman
Chairman and Chief Executive Officer

Real Estate Solutions as Distinct as You Are...

\$842.5

Million

in loans and investments

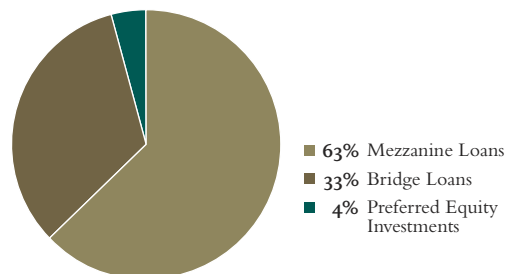
Arbor Realty Trust provides structured finance products to a diverse group of asset classes across a wide geographic region with a primary focus on commercial and multifamily markets. Arbor's product offerings include bridge and mezzanine loans, preferred and direct equity investments, mortgage-related securities and other real estate-related assets.

Arbor offers a broad range of capital that can be tailored to meet almost any financial need. The competitive advantages we have developed have helped us carve a unique and respected "niche" in the real estate finance investment industry.

Arbor knows that every client has distinct needs. That's why we approach each client differently. With a national origination platform and a highly skilled team of real estate and finance experts, we are able to understand the nuances of every transaction and create a custom-tailored solution that fits the individual requirements of high-end real estate owners.

We offer a diverse and versatile product line and a personal experience that isn't easily found in a highly commoditized industry. We have built our business on relationships, and it shows. Seventy-five percent of our business comes from repeat borrowers.

Current Loan Portfolio



Equity Participation Interests...a Real Kicker

\$1.717

Million

Part of Arbor's unique business model is owning an equity participation interest or "equity kicker" in some of the real estate properties we finance. One such property in which we own an interest is Prime Retail Outlets, Inc. In 2004, this asset performed well, enabling us to receive distributions in the amount of \$1.7 million. Arbor currently holds five equity kickers on various assets.

CREDIT QUALITY

Arbor maintains strong credit quality. This is the result of the integration of our underwriting, structuring and asset management areas. Low-cost funding coupled with this superior track record results in attractive returns for our shareholders. Maximizing shareholder value is our main goal.

Prime Retail Outlet Centers

24 Outlets in 17 States

- Built in 1998, Prime Retail, Inc. is one of the leading factory outlet center operators in the United States.
- Identifying a “value play” with an opportunity to capture the equity trapped in Prime’s real estate holdings, Arbor teamed up with one of its existing clients to raise the \$638,000,000 in financing needed in order to acquire all of the company’s outstanding shares and take it private.
- Arbor structured a \$35,000,000 mezzanine loan that provided the client with the speed and flexibility necessary to close a highly complicated transaction within “time-of-essence” requirements.
- With Arbor’s backing, the client has sold several non-core properties and is planning for the redevelopment of several core properties that offer significant upside potential.





◀ **The Sagamore Hotel**
1671 Collins Avenue, Miami Beach, FL
92,000 Square Feet

- In 2002, the owner completed a full renovation of this 93-room boutique hotel located in the heart of South Beach, Miami's Art Deco District.
- After successfully repositioning the asset, the owner teamed up with a top tier hotel management firm to manage the daily operations of the hotel.
- Implementing a strategy to further improve operations, the owner partnered with Arbor for a \$30,000,000 bridge loan to refinance the existing debt and facilitate construction of an upscale restaurant designed to adorn the lobby of what has now become known as Miami's "Art Hotel."
- The upscale eating establishment is projected to open in 2005.

The James Hotel
7353 East Indian School Road, Scottsdale, AZ
131,600 Square Feet

- The James Hotel is a new, highly stylized hotel brand that provides superior quality at affordable prices.
- Arbor's Structured Finance Group provided the owners with the original \$6,640,000 mezzanine loan to facilitate the acquisition and renovation of their 200-key flagship hotel in Scottsdale.
- Amenities include the owner's branded Fiamma restaurant and J-Bar, one of Arizona's longest lap pools, 42" plasma televisions in every room and Wi-Fi access throughout the resort, including poolside.
- After the success of the James brand since opening, Arbor provided an additional \$14,500,000 mezzanine loan to facilitate the acquisition and renovation of a well-located existing hotel in Chicago. Upon completion of the scheduled renovations, this hotel will become the second location within the growing James brand. A pledge of the ownership interests in the James Hotel Scottsdale provided additional collateral for Arbor's loan.



Versatility You Can Count on...

Bridge Mezzanine Preferred Equity

Arbor Realty Trust offers a one-stop source for customized financing solutions in the form of a broad and versatile product line. From bridge and mezzanine financing to preferred investments, Arbor has a solid track record of meeting clients' needs to assure they are receiving the most creative, custom financing that is available in today's marketplace.

Any deal can be proposed. What sets us apart is the way we move a deal through our internal channels. Arbor works vigorously with its clients during the life of a loan, ensuring its execution and delivering the highest quality of service.

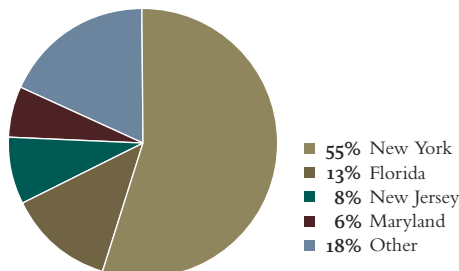
Once a transaction is funded, our work continues. Unlike some large lending companies that turn their loans over to a third-party servicer, our loans are serviced by Arbor's internal asset management department. This department is supported by the mortgage servicing team at Arbor Commercial Mortgage, our external manager, which has nearly 25 years of experience in providing dedicated commercial mortgage servicing and maintains a loan portfolio of more than \$3.5 billion.

THE MISSION CONTINUES...

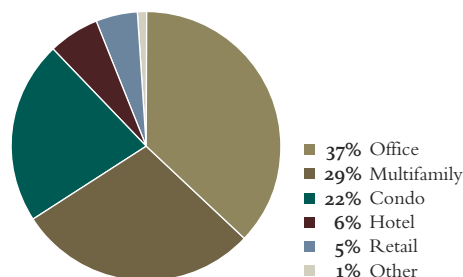
Our mission is to be the nation's premier real estate finance investment franchise by offering the most comprehensive, customized and creative structured finance solutions available to the real estate industry.

We are a business built on a strong foundation of experience. We will continue to build on our expertise and our solid performance.

Geographic Diversity



Asset Class Diversity



“THE ARBOR FRANCHISE IS BUILT ON SEVERAL CORE PRINCIPLES: *expanding and strengthening our portfolio, enhancing customer relationships, maintaining excellent credit quality and building our brand reputation within the commercial real estate finance market.*”

–Ivan Kaufman



▲
130 West 30th Street, New York, NY
91,431 Square Feet

- Located in New York City's Chelsea area and built in 1929, this pre-war landmark commercial building is famous for its visionary architect, Cass Gilbert, whose other works include such notable structures as the Woolworth Building, the Union Club and the New York Life Insurance Building.
- Its owner had a vision of converting the structure into 45 luxury residential condominiums.
- Arbor provided \$24,000,000 in the form of bridge and mezzanine financing, allowing the developer to acquire the property, renovate the units and complete the conversion.
- The units sold out before the conversion was complete, and the property's value has grown significantly.

60 Spring Street, New York, NY
69,251 Square Feet ▶

- Located in a prime section of New York City in SoHo/NoLita, this structure was built in the mid 1920s and designed by renowned American architect Cass Gilbert. The property formerly served as the home of the East River Savings Bank.
- In 2003, developers purchased the property and undertook converting the building into 42 super-luxury condominium units.
- Arbor provided a unique blend of financing, including bridge, first mortgage and mezzanine loans for a combined \$74,300,000. Loan proceeds were used to fund ongoing construction and renovation costs.



Contents

10	Selected Consolidated Financial Information of Arbor Realty Trust, Inc. and Subsidiaries
11	Selected Consolidated Financial Information of the Structured Finance Business of Arbor Commercial Mortgage, LLC and Subsidiaries
13	Management's Discussion and Analysis of Financial Condition and Results of Operations of Arbor Realty Trust, Inc. and Subsidiaries
25	Management's Discussion and Analysis of Financial Condition and Results of Operations of the Structured Finance Business of Arbor Commercial Mortgage, LLC and Subsidiaries
33	Report of Independent Registered Public Accounting Firm
34	Consolidated Balance Sheets
35	Consolidated Income Statements
36	Consolidated Statements of Stockholders' Equity for the Period June 24, 2003 (Inception) to December 31, 2003 and for the Year Ended December 31, 2004
37	Consolidated Statements of Cash Flows
38	Notes to Consolidated Financial Statements
53	Report of Independent Registered Public Accounting Firm
54	Report of Independent Registered Public Accounting Firm
55	The Structured Finance Business of Arbor Commercial Mortgage, LLC and Subsidiaries Consolidated Statements of Revenue and Direct Operating Expenses
56	The Structured Finance Business of Arbor Commercial Mortgage, LLC and Subsidiaries Notes to Consolidated Financial Statements
60	Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

SELECTED CONSOLIDATED FINANCIAL INFORMATION of *Arbor Realty Trust, Inc. and Subsidiaries*

The following tables present selected historical consolidated financial information as of December 31, 2004 and 2003 and for the year ended December 31, 2004 and the period from June 24, 2003 (inception) to December 31, 2003. The selected historical consolidated financial information presented below under the captions “Consolidated Income Statement Data” and “Consolidated Balance Sheet Data” have been derived from our audited consolidated financial statements and include all adjustments, consisting only of normal recurring accruals, which management considers necessary for a fair presentation of the historical consolidated financial statements for such period. The information presented under the caption “Consolidated Income Statement Data” for the period ended December 31, 2003 is not necessarily indicative of any other interim period. In addition, since the information presented below is only a summary and does not provide all of the information contained in our historical consolidated financial statements, including the related notes, you should read it in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations of Arbor Realty Trust, Inc. and Subsidiaries” and our historical consolidated financial statements, including the related notes, included elsewhere in this report.

	Year Ended December 31, 2004	Period from June 24, 2003 (Inception) to December 31, 2003
Consolidated Income Statement Data:		
Interest income	\$ 57,927,230	\$ 10,012,449
Other income	42,265	156,502
Total revenue	57,969,495	10,168,951
Management fees—related party	3,614,830	587,734
Total expenses	27,545,997	5,452,865
Net income	25,072,682	3,407,919
Earnings per share, basic	1.81	0.42
Earnings per share, diluted ⁽¹⁾⁽²⁾	1.78	0.42
Dividends declared per common share ⁽³⁾	1.16	0.50
	At December 31, 2004	At December 31, 2003
Consolidated Balance Sheet Data		
Loans and investments, net	\$831,783,364	\$286,036,610
Related party loans, net	7,749,538	35,940,881
Total assets	912,295,177	338,164,432
Repurchase agreements	409,109,372	113,897,845
Notes payable	165,771,447	58,630,626
Total liabilities	589,292,273	183,416,716
Minority interest	60,249,731	43,631,602
Total stockholders’ equity	262,753,173	111,116,114
	Year Ended December 31, 2004	Period from June 24, 2003 (Inception) to December 31, 2003
Other Data		
Total originations	\$782,301,133	\$186,289,922

(1) As of December 31, 2004, ACM, our manager, earned incentive management fees totaling \$1.6 million. Based on the terms of the management agreement, ACM elected to be paid its incentive management fee in common shares totaling 66,141. These shares were anti-dilutive and have been excluded from the calculation of diluted earnings per share.

(2) The warrants underlying the units issued in the private placement at \$75.00 per unit have an initial exercise price of \$15.00 per share and expire on July 1, 2005. This exercise price is equal to the price per share of common stock underlying the units and approximates the market value of our common stock at December 31, 2003. Therefore, the assumed exercise of the warrants was not considered to be dilutive for purposes of calculating diluted earnings per share.

(3) On January 13, 2005 our board of directors authorized and we declared a distribution to our stockholders of \$0.47 per share of common stock, payable with respect to the quarter ended December 31, 2004, to stockholders of record at the close of business on January 31, 2005. We made this distribution on February 15, 2005.

SELECTED CONSOLIDATED FINANCIAL INFORMATION OF THE STRUCTURED
FINANCE BUSINESS *of Arbor Commercial Mortgage, LLC and Subsidiaries*

On July 1, 2003, Arbor Commercial Mortgage contributed a portfolio of structured finance investments and related liabilities to our operating partnership. In addition, certain employees of Arbor Commercial Mortgage became our employees. These assets, liabilities and employees represented a substantial portion of Arbor Commercial Mortgage's structured finance business.

The tables on the following page present selected historical consolidated financial information of the structured finance business of Arbor Commercial Mortgage at the dates and for the periods indicated. The structured finance business did not operate as a separate legal entity or business division or segment of Arbor Commercial Mortgage but as an integrated part of Arbor Commercial Mortgage's consolidated business. Accordingly, the statements of revenue and direct operating expenses do not include charges from Arbor Commercial Mortgage for corporate general and administrative expense because Arbor Commercial Mortgage considered such items to be corporate expenses and did not allocate them to individual business units. These expenses included costs for Arbor Commercial Mortgage's executive management, corporate facilities and overhead costs, corporate accounting and treasury functions, corporate legal matters and other similar costs. The selected consolidated financial information presented under the caption "Consolidated Statement of Revenue and Direct Operating Expenses Data" for the years ended December 31, 2002 and 2001, the six months ended June 30, 2003 and under the caption "Consolidated Statement of Assets and Liabilities Data" as of December 31, 2002 and 2001 have been derived from the audited consolidated financial statements of the structured finance business of Arbor Commercial Mortgage included elsewhere in this report. The selected consolidated financial information presented under the caption "Consolidated Statement of Revenue and Direct Operating Expenses Data" for the six months ended June 30, 2003 is not necessarily indicative of the results of any other interim period or the year ended December 31, 2003. The selected consolidated financial information presented under the caption "Consolidated Statement of Revenue and Direct Operating Expenses Data" for the year ended December 31, 2000 and the caption "Consolidated Statement of Assets and Liabilities Data" as of December 31, 2000 have also been derived from the audited consolidated financial statements of the structured finance business of

Arbor Commercial Mortgage. The selected consolidated financial information presented under the caption "Consolidated Statement of Assets and Liabilities Data" as of December 31, 2000 has been derived from the unaudited consolidated financial statements of the structured finance business of Arbor Commercial Mortgage.

The selected consolidated financial information presented under the caption "Consolidated Statement of Revenue and Direct Operating Expenses Data" for the six months ended June 30, 2002 have been derived from the unaudited interim consolidated financial statements of Arbor Commercial Mortgage's structured finance business and include all adjustments, consisting only of normal recurring accruals, which management considers necessary for a fair presentation of the historical consolidated financial information for such periods. The selected consolidated financial information presented under the caption "Consolidated Statement of Revenue and Direct Operating Expenses Data" for the six-month period ended June 30, 2002 are not necessarily indicative of the results of any other interim period or the year ended December 31, 2002.

The consolidated financial statements of Arbor Commercial Mortgage's structured finance business included in this report represent the consolidated financial position and results of operations of Arbor Commercial Mortgage's structured finance business during certain periods and at certain dates when Arbor Commercial Mortgage previously held our initial assets, as well as several other structured finance investments that we did not acquire in connection with our formation transactions. See "Arbor Realty Trust, Inc." Accordingly, the historical financial results of Arbor Commercial Mortgage's structured finance business are not indicative of our future performance. In addition, since the information presented is only a summary and does not provide all of the information contained in the consolidated financial statements of Arbor Commercial Mortgage's structured finance business, including related notes, you should read it in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations of the Structured Finance Business of Arbor Commercial Mortgage, LLC and Subsidiaries" and the consolidated financial statements of Arbor Commercial Mortgage's structured finance business, including related notes, contained elsewhere in this report.

SELECTED CONSOLIDATED FINANCIAL INFORMATION OF THE STRUCTURED
FINANCE BUSINESS of *Arbor Commercial Mortgage, LLC and Subsidiaries* (continued)

CONSOLIDATED STATEMENT OF REVENUE AND DIRECT OPERATING EXPENSES DATA:

	Six Months Ended		Year Ended December 31,		
	June 30,		2002	2001 ⁽¹⁾	2000 ⁽¹⁾
	2003	2002			
		(Unaudited)			
Interest Income	\$7,688,465	\$7,482,750	\$14,532,504	\$14,667,916	\$10,707,551
Income from the real estate held for sale, net of operating expenses	—	—	—	—	—
Other income	1,552,414	553,625	1,090,106	1,668,215	652,970
Total revenue	9,240,879	8,036,375	15,622,610	16,336,131	11,360,521
Total direct operating expenses	5,737,688	8,344,302	13,639,755	10,997,800	9,227,274
Revenue in excess of direct operating expenses before gain on sale of loans and real estate and income from equity affiliates	3,503,191	(307,927)	1,982,855	5,338,331	2,133,247
Gain on sale of loans and real estate	1,024,268	7,006,432	7,470,999	3,226,648	1,880,825
Income from equity affiliates	—	601,100	632,350	1,403,014	5,028,835
Revenue, gain on sale of loans and real estate and income from equity affiliates in excess of direct operating expenses	4,527,459	7,299,605	10,086,204	9,967,993	9,042,907

CONSOLIDATED STATEMENT OF ASSETS AND LIABILITIES DATA:

	At December 31,		
	2002	2001	2000
			(Unaudited)
Loans and investments, net	\$172,142,511	\$160,183,066	\$ 85,547,323
Related party loans, net	15,952,078	15,880,207	—
Investment in equity affiliates	2,586,026	2,957,072	20,506,417
Total assets	200,563,236	183,713,747	119,110,446
Notes payable and repurchase agreements	141,836,477	132,409,735	70,473,501
Total liabilities	144,280,806	134,086,301	72,266,700
Net assets	56,282,430	49,627,446	46,843,746

OTHER DATA (UNAUDITED):

	Six Months Ended June 30,		Year Ended December 31,		
	2003	2002	2002	2001	2000
Total Originations	\$117,965,000	\$30,660,000	\$130,043,000	\$86,700,000	\$108,378,000

(1) In June 1998, Arbor Commercial Mortgage entered into a joint venture with SFG I, an affiliate of Nomura Asset Capital Corp., for the purpose of acquiring up to \$250 million of structured finance investments. Arbor Commercial Mortgage and SFG I each made 50% of the capital contributions to the joint venture and shared profits equally. Nomura Asset Capital Corp. provided financing to the joint venture in the form of a repurchase agreement. On July 31, 2001, Arbor Commercial Mortgage purchased SFG I's interest in this venture. This buyout was accounted for by the purchase accounting method. Prior to the purchase, net income from this venture was recorded in income from equity affiliates.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS of *Arbor Realty Trust, Inc. and Subsidiaries*

You should read the following discussion in conjunction with the sections of this report entitled "Risk Factors," "Forward-Looking Statements," and "Selected Consolidated Financial Information of Arbor Realty Trust, Inc. and Subsidiaries" and the historical consolidated financial statements of Arbor Realty Trust, Inc. and Subsidiaries, including related notes, included elsewhere in this report.

OVERVIEW

We are a Maryland corporation that was formed in June 2003 to invest in real estate-related bridge and mezzanine loans, including junior participating interests in first mortgages, preferred equity and, in limited cases, discounted mortgage notes and other real estate-related assets, which we refer to collectively as structured finance investments. We also invest in mortgage-related securities. We conduct substantially all of our operations through our operating partnership and its wholly-owned subsidiaries.

Our operating performance is primarily driven by the following factors:

- *Net interest income earned on our investments*—Net interest income represents the amount by which the interest income earned on our assets exceeds the interest expense incurred on our borrowings. If the yield earned on our assets increases or the cost of borrowings decreases, this will have a positive impact on earnings. Net interest income is also directly impacted by the size of our asset portfolio.
- *Credit quality of our assets*—Effective asset and portfolio management is essential to maximizing the performance and value of a real estate/mortgage investment. Maintaining the credit quality of our loans and investments is of critical importance. Loans that do not perform in accordance with their terms may have a negative impact on earnings.
- *Cost control*—We seek to minimize our operating costs, which consist primarily of employee compensation and related costs, management fees and other general and administrative expenses. As the size of the portfolio increases, certain of these expenses, particularly employee compensation expenses, may increase.

We are organized and conduct our operations to qualify as a real estate investment trust, or a REIT and to comply with the provisions of the Internal Revenue Code of 1986, as amended, or the Code with respect thereto. A REIT is generally not subject to federal income tax on that portion of its REIT-taxable income which is distributed to its stockholders provided that at least 90% of its REIT-taxable income is distributed and provided that certain other requirements are met. Certain of our assets that produce non-qualifying income may be held in taxable REIT subsidiaries. Unlike other subsidiaries of a REIT, the income of a taxable REIT subsidiary is subject to federal and state income taxes. As

our taxable REIT subsidiaries have had minimal activity since their inception, we have determined that no provision for income taxes is necessary at this time.

On July 1, 2003, Arbor Commercial Mortgage ("ACM"), our manager, contributed \$213.1 million of structured finance assets, encumbered by \$169.2 million of borrowings in exchange for an equity interest in our operating partnership represented by 3,146,724 units of limited partnership interest and 629,345 warrants to acquire additional units of limited partnership interest. In addition, certain employees of ACM became our employees. We are externally managed and advised by ACM and pay ACM a management fee in accordance with a management agreement. ACM originates, underwrites and services all structured finance assets on behalf of our operating partnership.

Concurrently with ACM's asset contribution, we consummated a private placement of 1.6 million units, each consisting of five shares of our common stock and one warrant to purchase one share of common stock, for \$75.00 per unit, resulting in gross proceeds of \$120.2 million. Gross proceeds from the private placement combined with the concurrent equity contribution by ACM totaled approximately \$164.1 million in equity capital.

On April 13, 2004, we sold 6,750,000 shares of our common stock at a price to the public of \$20.00 per share, for net proceeds of approximately \$124.4 million after deducting the underwriting discount and the other estimated offering expenses. On May 11, 2004, we issued and sold 524,200 additional shares of common stock, for net proceeds of approximately \$9.8 million after deducting the underwriting discount pursuant to the exercise of a portion of the over-allotment option granted to the underwriters of our initial public offering. Additionally, as of December 31, 2004, we issued 973,354 shares of common stock from the exercise of warrants originally issued as a component of units on July 1, 2003, for proceeds of \$12.9 million.

CHANGES IN FINANCIAL CONDITION

During the year, we originated fifty-three loans and investments totaling \$782.3 million, of which \$746.1 million was funded as of December 31, 2004. Of the new loans and investments, twenty-three were mezzanine loans totaling \$387.5 million, twenty were bridge loans totaling \$300.8 million, five were junior participating interests totaling \$84.5 million, and five were direct equity investments totaling \$9.6 million. We have received full satisfaction of nineteen loans totaling \$181.4 million and partial repayment on seven loans totaling \$40.0 million. Also, we had sold one equity investment totaling \$3.0 million, two equity investments convert to loans totaling \$6.7 million and we recorded a \$0.5 million distribution for one of our equity investments.

Since December 31, 2004, we have originated seven loans totaling approximately \$134.7 million. In addition, we have received \$145.9 million for the repayment in full of ten loans and \$36.0 million for the partial repayment of two loans.

Our loan portfolio balance at December 31, 2004 was \$842.5 million, with a weighted average current interest pay rate of 8.87%, as compared to \$323.5 million, with a weighted average interest pay rate of 7.49%, at December 31, 2003. At December 31, 2004, advances on financing facilities totaled \$530.7 million, with a weighted average funding cost of 5.05% as compared to \$172.5 million, with a weighted average funding cost of 3.40%, at December 31, 2003. Additionally, our joint venture investment portfolio at December 31, 2004 was \$5.3 million as compared to \$5.9 million at December 31, 2003.

In March 2004, we purchased \$57.4 million (including \$0.1 million of purchased interest) of agency-sponsored whole pool mortgage-related securities. Pools of FNMA and FHLMC adjustable rate residential mortgage loans underlie these mortgage-related securities. We receive payments based on the payments that are made on these mortgage loans. The underlying mortgage loans have a fixed rate of interest for three years and adjust annually thereafter. These loans have a weighted average coupon rate of 3.8%. Of these mortgage-related securities, \$20.6 million were issued by FNMA and \$36.7 million were issued by FHLMC. At December 31, 2004, the amortized cost of these securities was \$47.1 million. We are carrying these securities at their estimated fair value of \$46.6 million, which resulted in a \$0.5 million unrealized loss that was recorded in other comprehensive loss. At December 31, 2004, the outstanding balance on the financing of these securities was \$44.2 million.

On January 19, 2005, the Company completed a non-recourse collateralized debt obligation ("CDO") transaction, whereby a portfolio of real estate-related assets were contributed to a consolidated subsidiary which issued \$305 million of investment grade-rated floating-rate notes in a private placement. The subsidiary retained the equity interest in the issuer with a value of approximately \$164 million. The notes are secured by a portfolio of real estate-related assets with a face value of approximately \$441 million, consisting primarily of bridge loans, mezzanine loans and junior participating interests in first mortgages, and by approximately \$28 million of cash available for acquisitions of loans and other permitted investments. The notes have an initial weighted average spread of approximately 77 basis points over three-month LIBOR. The facility has a four-year replenishment period that allows the principal proceeds from repayments of the collateral assets to be reinvested in qualifying replacement assets, subject to certain conditions. The Company

intends to own the portfolio of real estate-related assets until its maturity and will account for this transaction on its balance sheet as a financing. These proceeds were used to repay outstanding debt with higher costs of funds. In connection with the CDO, the Company entered into an interest rate swap agreement to hedge its exposure to the risk of changes in the difference between three-month LIBOR and one-month LIBOR.

SOURCES OF OPERATING REVENUES

We derive our operating revenues primarily through interest received from making real estate-related bridge and mezzanine loans and preferred equity investments. Interest income earned on these loans and investments represented approximately 96% and 98% of our total revenues in 2004 and for the period ended December 31, 2003, respectively.

Interest income is also derived from profits of equity participation interests. In 2004, interest income from participation interests represented approximately \$1.2 million or 2% of total revenues. No income was derived from this source in 2003.

We also derive interest income from our investments in mortgage related securities. In 2004, interest on these investments represented approximately 2% of our total revenues. No income was derived from this source in 2003.

Additionally, we also derive operating revenues from other income that represents loan structuring and miscellaneous asset management fees associated with our loans and investments portfolio. Revenue from other income represented less than 1% and 2% of our total revenues in 2004 and the period ended December 31, 2003, respectively.

GAIN ON SALE OF LOANS AND REAL ESTATE AND INCOME FROM EQUITY AFFILIATES

We may derive income from the gain on sale of loans and real estate. We may acquire (1) real estate for our own investment and, upon stabilization, disposition at an anticipated return and (2) real estate notes generally at a discount from lenders in situations where the borrower wishes to restructure and reposition its short-term debt and the lender wishes to divest certain assets from its portfolio. No such income has been recorded to date.

We also derive income from equity affiliates relating to joint ventures that were formed with equity partners to acquire, develop and/or sell real estate assets. Such investments are recorded under the equity method. We record our share of net income from the underlying properties in which we invest through these joint ventures. In 2004, income from equity affiliates totaled \$525,000.

SIGNIFICANT ACCOUNTING ESTIMATES AND CRITICAL ACCOUNTING POLICIES

Management's discussion and analysis of financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with U.S. Generally Accepted Accounting Principles ("GAAP"). The preparation of financial statements in conformity with GAAP requires the use of estimates and assumptions that could affect the reported amounts in our consolidated financial statements. Actual results could differ from these estimates. A summary of our significant accounting policies is presented in Note 2 to our consolidated financial statements, which appear in "Financial Statements and Supplementary Data." Set forth below is a summary of the accounting policies that management believes are critical to the preparation of the consolidated financial statements included in this report. Certain of the accounting policies used in the preparation of these consolidated financial statements are particularly important for an understanding of the financial position and results of operations presented in the historical consolidated financial statements included in this report and require the application of significant judgment by management and, as a result, are subject to a degree of uncertainty.

LOANS AND INVESTMENTS

SFAS No. 115 requires that at the time of purchase, we designate a security as held to maturity, available-for-sale, or trading depending on ability and intent. Securities held for sale are reported at fair value, while securities and investments held to maturity are reported at amortized cost. We do not have any trading securities at this time.

Loans held for investment are intended to be held to maturity and, accordingly, are carried at cost, net of unamortized loan origination costs and fees, unless such loan or investment is deemed to be impaired. We invest in preferred equity interests that allow us to participate in a percentage of the underlying property's cash flows from operations and proceeds from a sale or refinancing. At the inception of each such investment, management must determine whether such investment should be accounted for as a loan, joint venture or as real estate. To date, management has determined that all such investments are properly accounted for and reported as loans.

Specific valuation allowances are established for impaired loans based on the fair value of collateral on an individual loan basis. The fair value of the collateral is determined by an evaluation of operating cash flow from the property during the projected holding period, and estimated sales value computed by applying an expected capitalization rate to the stabilized net operating income of the specific property, less selling costs, discounted at market discount rates. If upon completion of the valuation, the fair value of the underlying

collateral securing the impaired loan is less than the net carrying value of the loan, an allowance is created with a corresponding charge to the provision for loan losses. An allowance for each loan would be maintained at a level believed adequate by management to absorb probable losses. As of December 31, 2004, no impairment has been identified and no valuation allowances have been established.

AVAILABLE-FOR-SALE SECURITIES

We invest in agency-sponsored whole pool mortgage-related securities. Pools of Federal National Mortgage Association ("FNMA") and Federal Home Loan Mortgage Corporation ("FHLMC") adjustable rate residential mortgage loans underlie these mortgage-related securities. We receive payments from the payments that are made on these underlying mortgage loans, which have a fixed rate of interest for three years and adjust annually thereafter. These securities are carried at their estimated fair value with unrealized gains and losses excluded from earnings and reported in other comprehensive income pursuant to SFAS No. 115 "Accounting for Certain Investments in Debt and Equity Securities." Unrealized losses other than temporary losses are recognized currently in income.

REVENUE RECOGNITION

Interest Income. Interest income is recognized on the accrual basis as it is earned from loans, investments and available-for-sale securities. In many instances, the borrower pays an additional amount of interest at the time the loan is closed, an origination fee, and deferred interest upon maturity. In some cases interest income may also include the amortization or accretion of premiums and discounts arising at the purchase or origination. This additional income, net of any direct loan origination costs incurred, is deferred and accreted into interest income on an effective yield or "interest" method adjusted for actual prepayment activity over the life of the related loan or available-for-sale security as a yield adjustment. Income recognition is suspended for loans when in the opinion of management a full recovery of income and principal becomes doubtful. Income recognition is resumed when the loan becomes contractually current and performance is demonstrated to be resumed. Several of the loans provide for accrual of interest at specified rates, which differ from current payment terms. Interest is recognized on such loans at the accrual rate subject to management's determination that accrued interest and outstanding principal are ultimately collectible, based on the underlying collateral and operations of the borrower. If management cannot make this determination regarding collectibility, interest income above the current pay rate is recognized only upon actual receipt. Additionally, interest income is recorded when earned from equity participation interests, referred to as equity kickers. These equity kickers have the potential to generate additional

revenues to the Company as a result of excess cash flows being distributed and/or as appreciated properties are sold or refinanced.

DERIVATIVES AND HEDGING ACTIVITIES

In accordance with Statement of Financial Accounting Standards ("SFAS") No. 133 "Accounting for Derivative Instruments and Hedging Activities," the carrying values of interest rate swaps, as well as the underlying hedged liability, if applicable, are reflected at their fair value. We rely on quotations from a third party to determine these fair values. Derivatives that are not hedges are adjusted to fair value through income. If the derivative is a hedge, depending on the nature of the hedge, changes in the fair value of the derivative are either offset against the change in the fair value of the hedged liability through earnings or recognized in other comprehensive income until the hedged item is recognized in earnings. The ineffective portion of a derivative's change in fair value is immediately recognized in earnings.

Because the valuations of our hedging activities are based on estimates, the fair value may change if our estimates are inaccurate. For the effect of hypothetical changes in market interest rates on our interest rate swaps, see the Market Risk section.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In January 2003, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46"), which requires a variable interest entity ("VIE") to be consolidated by its primary beneficiary ("PB"). The PB is the party that absorbs a majority of the VIE's anticipated losses and/or a majority of the expected returns.

In December 2003, the FASB revised FIN 46 ("FIN 46(R)"), delaying the effective date for certain entities created before February 1, 2003 and making other amendments to clarify the application of the guidance. FIN 46(R) is effective no later than the end of the first interim or annual period ending after December 15, 2003 for entities created after January 31, 2003 and for entities created before February 1, 2003, no later than the end of the first interim or annual period ending after March 15, 2004. As required, we adopted the guidance of FIN 46(R) accordingly.

In adopting FIN 46 and FIN 46(R), we have evaluated our loans and investments and investments in equity affiliates to determine whether they are VIEs. This evaluation resulted in us determining that our mezzanine loans, preferred equity investments and investments in equity affiliates were potential variable interests. For each of these investments, we have evaluated (1) the sufficiency of the fair value of the entities' equity investments at risk to absorb losses, (2) that as a group the holders of the equity investments at risk have (a) the direct or indirect ability through voting rights to make decisions about the entities' significant activities, (b) the obligation

to absorb the expected losses of the entity and their obligations are not protected directly or indirectly, (c) the right to receive the expected residual return of the entity and their rights are not capped, (3) the voting rights of some of these investors are proportional to their obligations to absorb the expected losses of the entity, their rights to receive the expected returns of the equity, or both, and (4) that substantially all of the entities' activities do not involve or are not conducted on behalf of an investor that has disproportionately few voting rights. As of December 31, 2004, we have identified four loans and investments which were made to entities determined to be VIEs. A summary of our identified VIEs is presented in Note 2 of our consolidated financial statements, which appear in "Financial Statements and Supplementary Data." For the four VIEs identified, we have determined that we are not the primary beneficiaries and as such the VIEs should not be consolidated in our financial statements. For all other investments, we have determined they are not VIEs. As such, we have continued to account for these loans and investments as a loan or joint venture, as appropriate.

In March 2004, the SEC released SAB 105, "Application of Accounting Principles to Loan Commitments," providing guidance on how to account for a commitment to purchase a mortgage loan prior to funding the loan. SAB 105 requires that these commitments be recorded at fair value with changes in fair value recognized in current earnings and was intended to eliminate the diversity in industry practice that existed relating to the accounting for loan commitments. SAB 105 is effective for loan commitments entered into after March 31, 2004. Our method of accounting for loan commitments is consistent with the guidance provided by SAB 105.

In December 2003, the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants issued SOP 03-3, "Accounting for Certain Loans or Debt Securities Acquired in a Transfer." SOP 03-3 addresses the accounting for acquired impaired loans, which are loans that show evidence of having deteriorated in terms of credit quality since their origination. SOP 03-3 is effective for loans acquired after December 31, 2004. We do not expect the adoption of SOP 03-3 to have a material effect on our financial condition, results of operations, or liquidity.

In June 2004, the FASB issued EITF 03-01, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments." EITF 03-01 requires an investor to determine when an investment is considered impaired, evaluate whether that impairment is other than temporary, and, if the impairment is other than temporary, recognize an impairment loss equal to the difference between the investment's cost and its fair value. The guidance also includes accounting considerations subsequent to the recognition of an other-than-temporary impairment and requires certain

disclosures about unrealized losses that have not been recognized as other-than-temporary impairments. The impairment loss recognition and measurement guidance was to be applicable to other-than-temporary impairment evaluations in reporting periods beginning after June 15, 2004. In September 2004, the FASB proposed additional guidance related to debt securities that are impaired because of interest rate and/or sector spread increases, and delayed the effective date of EITF 03-01. We do not expect the adoption of EITF 03-01 to have a material effect on our financial condition, results of operations, or liquidity. EITF 03-01 also includes disclosure requirements for investments in an unrealized loss position for which other-than-temporary impairments have not been recognized. These disclosures are included in our report for the year ended December 31, 2004 as required by the EITF.

In December 2004, the FASB published SFAS 123(R) entitled "Share-Based Payment." It requires all public companies to report share-based compensation expense at the grant date fair value of the related share-based awards. We are required to adopt the provisions of the standard effective for periods beginning after June 15, 2005. We believe that our current method of accounting for share-based payments is consistent with SFAS 123(R).

RESULTS OF OPERATIONS

The following table sets forth our results of operations for the year ended December 31, 2004 and for the period from June 24, 2003 (Inception) to December 31, 2003:

	Year Ended December 31, 2004	Period June 24, 2003 (Inception) to December 31, 2003
Revenue:		
Interest income	\$57,927,230	\$10,012,449
Other income	42,265	156,502
Total revenue	57,969,495	10,168,951
Expenses:		
Interest expense	19,372,575	1,669,731
Employee compensation and benefits	2,325,727	940,336
Stock-based compensation	324,343	1,721,367
Selling and administrative	1,908,522	533,697
Management fee—related party	3,614,830	587,734
Total expenses	27,545,997	5,452,865
Income before minority interest and income from equity affiliates	30,423,498	4,716,086
Income from equity affiliates	525,000	—
Income before minority interest	30,948,498	4,716,086
Income allocated to minority interest	5,875,816	1,308,167
Net income	\$25,072,682	\$ 3,407,919

Revenue

Interest income increased \$47.9 million, or 479%, to \$57.9 million in 2004 from \$10.0 million for the period ended December 31, 2003. This increase was due to a full year's results in 2004 as compared to a partial year's results in 2003, a 149% increase in the average balance of the loan and investment portfolio from \$254.9 million for the period ended December 31, 2003 to \$635.1 million in 2004 due to increased loan and investment originations, as well as a 14% increase in the average yield on the assets from 7.7% to 8.8% as a result of increased market interest rates. In addition, interest income in 2004 included a \$1.2 million participation interest earned and received on one of our loans as compared to no participation interest recorded during the period ending December 31, 2003. Interest income from available-for-sale securities in 2004 was \$1.1 million, with an average available-for-sale securities balance of \$51.9 million and an average yield of 2.1%. There was no interest income recorded from available-for-sale securities during the period ended December 31, 2003.

Other income decreased \$114,000, or 73%, to \$42,000 in 2004 from \$157,000 for the period ended December 31, 2003. This income represents loan structuring and miscellaneous asset management fees associated with our loan and investment portfolio.

Expenses

Interest expense increased \$17.7 million, or 1,060%, to \$19.4 million in 2004 from \$1.7 million for the period ended December 31, 2003. This increase was due to a full year's results in 2004 as compared to a partial year's results in 2003, a 315% increase in the average debt financing on our loan and investment portfolio from \$92.5 million for the period ended December 31, 2003 to \$383.8 million in 2004 due to increased loan and portfolio originations, as well as a 37% increase in the average cost of these borrowings from 3.5% to 4.8% as a result of increased market interest rates. In addition, interest expense on debt financing of our available-for-sale securities portfolio in 2004 was \$0.6 million, with an average debt financing on our available-for-sale securities balance of \$50.3 million and an average yield of 1.24%. There was no interest expense recorded from available-for-sale securities during the period ended December 31, 2003.

Employee compensation and benefits expense increased \$1.4 million, or 147%, to \$2.3 million in 2004 from \$0.9 million for the period ended December 31, 2003. This increase was due to a full year's results in 2004 as compared to a partial year's results in 2003 combined with the expansion of staffing needs associated with strengthening our organization as a publicly traded company in 2004. These expenses represent salaries, benefits, and incentive compensation for those employed by us during these periods.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS *of Arbor Realty Trust, Inc. and Subsidiaries (continued)*

Stock-based compensation expense decreased \$1.4 million, or 82%, to \$0.3 million in 2004 from \$1.7 million for the period ended December 31, 2003. This decrease was primarily due to a greater portion of the restricted stock grants vesting for the period ended December 31, 2003 partially offset by a full year's results in 2004 as compared to a partial year's results in 2003. This expense represents the cost of restricted stock granted to certain of our employees, executive officers and directors and certain executive officers and employees of our manager. Of the total shares granted, two-thirds of the shares granted vested immediately and the remaining one-third vests over three years. The amount of compensation expense recorded for the period ended December 31, 2003 represents the full expense of the initial two-thirds vesting and a ratable portion of the expense of the unvested shares. The amount of expense in 2004 represents a ratable portion of the expense of the unvested shares.

Selling and administrative expense increased \$1.4 million, or 258%, to \$1.9 million in 2004 from \$0.5 million for the period ended December 31, 2003. This increase was directly attributable to a full year's results in 2004 as compared to a partial year's results in 2003 combined with an increase in professional fees, including legal and accounting services, insurance expense and director's fees associated with operating a public company since our filing in 2004.

Management fees increased \$3.0 million, or 515%, to \$3.6 million in 2004 from \$2.0 million for the period ended December 31, 2003. This increase was directly attributable to a full year's results in 2004 as compared to a partial year's results in 2003, combined with \$1.6 million in incentive management fees recorded in 2004 not earned during the period ended December 31, 2003 due to the requirements for incentive compensation not satisfied, as well as an increase in the average base management fees associated with increased stockholders' equity directly attributable to greater profits and contributed capital.

Income from Equity Affiliates

Income from equity affiliates was \$525,000 in 2004. This amount represents an allocation of income from one of our joint venture interests. For the period ended December 31, 2003, no income from equity affiliates was recorded.

Income Allocated to Minority Interest

Income allocated to minority interest increased \$4.6 million, or 349%, to \$5.9 million in 2004 from \$1.3 million for the period ended December 31, 2003. These amounts represent the portion of our income allocated to our manager. This increase was due to a full year's results in 2004 as compared to a partial year's results in 2003, combined with a 556% increase in income before minority interest, partially offset by a decrease in our manager's limited partnership interest in us. Our manager owned a 18.7% and 27.7% limited partnership interest in our operating partnership and

was allocated 18.7% and 27.7% at December 31, 2004 and 2003, respectively.

LIQUIDITY AND CAPITAL RESOURCES

Sources of Liquidity

Liquidity is a measurement of the ability to meet potential cash requirements, including ongoing commitments to repay borrowings, fund loans and investments and other general business needs. Our primary sources of funds for liquidity consist of funds raised from our private equity offering in July 2003, net proceeds from our initial public offering of our common stock in April 2004, the issuance of floating rate notes pursuant to a CDO (described below) in January 2005, borrowings under credit agreements, net cash provided by operating activities, repayments of outstanding loans and investments, funds from junior and senior loan participation arrangements and the future issuance of common, convertible and/or preferred equity securities.

In 2003, we received gross proceeds from the private placement totaling \$120.2 million, which combined with ACM's equity contribution of \$43.9 million, resulted in total contributed capital of \$164.1 million. These proceeds were used to pay down borrowings under our existing credit facilities.

In 2004, we sold 6,750,000 shares of our common stock in a public offering on April 13, 2004 for net proceeds of approximately \$125.4 million. We used the proceeds to pay down indebtedness. In addition, in May 2004, the underwriters exercised a portion of their over-allotment option, which resulted in the issuance of 524,200 additional shares for net proceeds of approximately \$9.8 million. Additionally, in 2004, 1.3 million common stock warrants were exercised which resulted in proceeds of \$12.9 million. Also, Arbor Realty Limited Partnership ("ARLP"), the operating partnership of Arbor Realty Trust received proceeds of \$9.4 million from the exercise of ACM's warrants for a total of 629,345 operating partnership units.

We also maintain liquidity through one warehouse credit agreement, one unsecured revolving credit agreement, five master repurchase agreements, and one secured term credit facility with seven different financial institutions. London interbank offered rate, or LIBOR, refers to one-month LIBOR unless specifically stated.

We have a \$250.0 million warehouse credit agreement with a financial institution, dated as of July 1, 2003, with a term of three years and bears interest at LIBOR plus pricing of 2.00% to 2.75%, varying on type of asset financed. In the event this facility is not renewed, we have nine months to repay all outstanding advances. In addition to LIBOR-based interest obligations, this warehouse credit facility includes a profit sharing agreement, whereby the institution shares in the net interest spread of the assets financed. The profit sharing component represents the percentage of the net profits

earned over the life of a loan that are payable to the lender upon repayment of the underlying investment. Net profits are based on interest income, interest expense and deferred interest payable at repayment of an investment. At December 31, 2004, the outstanding balance under this facility was \$137.2 million with a current weighted average note rate of 4.87%. On January 19, 2005, \$36 million of this facility was paid down in connection with the CDO (see below). In addition, on March 29, 2005, we terminated this facility scheduled to expire in June 2006. We simultaneously repaid all indebtedness outstanding on that date. This debt underlying certain of our assets was transferred to our other facilities described below.

We have a \$100.0 million master repurchase agreement with a second financial institution, as amended in December 2004, that has a term expiring in June 2005 and bears interest at LIBOR plus pricing of 2.00% to 2.75%, varying on type of asset financed. At December 31, 2004, the outstanding balance under this facility was \$19.5 million with a current weighted average note rate of 5.43%. Subsequent to December 31, 2004, \$7 million of this facility was paid down in connection with the CDO (see below).

We have a \$350.0 million master repurchase agreement with Wachovia Bank National Association, dated as of December 23, 2003, with a term of three years and bears interest at LIBOR plus pricing of 0.94% to 3.65%, varying on type of asset financed. In July 2004, this repurchase agreement was amended increasing the amount of available financing from \$250 million to \$350 million and amending certain terms of this agreement, which were generally more favorable to us. This amendment has an expiration date of July 2005. In December 2004, we amended this facility on a temporary basis which provided for an increase in the amount of financing available under this facility from \$350 million to \$430 million, and expired in February 2005. At December 31, 2004, the outstanding balance under this facility was \$324.4 million with a current weighted average note rate of 4.63%. Subsequent to December 31, 2004, \$203 million of this facility was paid down in connection with the CDO (see below). In addition, we have a \$100 million repurchase agreement with the same financial institution as above that we entered into for the purpose of financing our securities available-for-sale. This agreement expires on July 2005 and has an interest rate of LIBOR plus 0.15%. At December 31, 2004, the outstanding balance under this facility was \$44.2 million with a current weighted average note rate of 2.36%.

We entered into a \$21 million repurchase agreement with a fourth financial institution, dated July 30, 2004 for the purpose of financing a \$30 million mezzanine loan which was purchased from this institution. The agreement provides for a 70% advance rate of the current loan balance, interest to be paid monthly at LIBOR plus 1.50%, and has a term that will expire in April 2005. Subsequent to December 31, 2004, this loan was contributed to the portfolio of the CDO and the debt financing was paid in full (see below).

We have a \$50.0 million master repurchase agreement with a fifth financial institution, dated as of July 1, 2003, which matures in November 2005 and bears interest at LIBOR plus pricing of 2.00% to 2.75%, varying on type of asset financed. This facility has not yet been utilized.

We have a \$50.0 million unsecured revolving credit agreement with a sixth financial institution, dated December 7, 2004, with a term of one year with two one-year extension options and an interest rate of LIBOR plus 7.00%. This revolving credit facility is primarily used to manage the timing difference between when new loans and investments are closed and when they are financed within one of the warehouse credit or master repurchase agreements. At December 31, 2004, the outstanding balance under this facility was \$15.0 million with a current weighted average note rate of 9.37%.

In January 2005, we closed a \$50 million term credit facility with a seventh financial institution who beneficially owned approximately 7.1% of our outstanding common stock as of December 31, 2004. This agreement has a term of one year with two six-month renewal options and bears interest at LIBOR plus 6.00%. On February 28, 2005, the outstanding balance under this facility was \$30.0 million with a current weighted average note rate of 8.72%.

In January 2005, we completed a non-recourse CDO transaction, whereby \$469 million of real estate related and other assets were contributed to a newly-formed consolidated subsidiary which issued \$305 million of investment grade-rated floating-rate notes in a private placement. These proceeds were used to repay outstanding debt under our current facilities totaling \$267 million. By contributing these real estate assets to the CDO, this transaction resulted in a decreased cost of funds relating to the CDO assets and created capacity in our existing credit facilities.

On March 15, 2005, we, through a newly-formed, wholly-owned subsidiary of its operating partnership, issued \$27.1 million of junior subordinated notes in a private placement. These securities are unsecured, have a maturity of 29 years, pay interest quarterly at a floating rate of interest based on LIBOR and, absent the occurrence of special events, are not redeemable during the first five years.

The warehouse credit agreement, unsecured revolving credit agreement, and the master repurchase agreements require that we pay interest monthly, based on pricing over LIBOR. The amount of our pricing over LIBOR varies depending upon the structure of the loan or investment financed pursuant to the warehouse credit agreement or the master repurchase agreement.

The warehouse credit agreement, the master repurchase agreements and the secured term credit facility require that we pay down borrowings under these facilities pro-rata as principal payments on our loans and investments are received. In addition, if upon maturity of a loan or investment we decide to grant the borrower an extension option, the financial institutions have the option to extend the borrowings or request payment in full on the outstanding borrowings of the loan or investment extended. The financial institutions also have the right to request immediate payment of any outstanding borrowings on any loan or investment that is at least 60 days delinquent.

As of December 31, 2004, these facilities had an aggregate capacity of \$1.0 billion and borrowings were approximately \$561.3 million.

Each of the credit facilities contains various financial covenants and restrictions, including minimum net worth and debt-to-equity ratios. In addition to the financial terms and capacities described above, our credit facilities generally contain covenants that prohibit us from effecting a change in control, disposing of or encumbering assets being financed and restrict us from making any material amendment to our underwriting guidelines without approval of the lender. If we violate these covenants in any of our credit facilities, we could be required to repay all or a portion of our indebtedness before maturity at a time when we might be unable to arrange financing for such repayment on attractive terms, if at all. Violations of these covenants may result in our being unable to borrow unused amounts under our credit facilities, even if repayment of some or all borrowings is not required. As of December 31, 2004, we are in compliance with all covenants and restrictions under these credit facilities.

In addition, we have entered into two junior loan participations with a total outstanding balance at December 31, 2004, of \$10.6 million. These participation borrowings have maturity dates equal to the corresponding mortgage loan and are secured by the participant's interest in the mortgage loan. Interest expense is based on a portion of the interest received from the loan.

We entered into one senior loan participation with a total outstanding balance as of December 31, 2004 of \$3.0 million. Interest expense relating to this senior participation was based on 50% of the net spread on the loan. In January 2005, the senior loan participation was repaid in full.

We believe our existing sources of funds will be adequate for purposes of meeting our short-term liquidity (within one year) and long-term liquidity needs. Our short-term and long-term liquidity needs include ongoing commitments to repay borrowings, fund future investments, fund operating costs and fund distributions to our stockholders. Our loans and investments are financed under existing credit facilities and their credit status is continuously monitored; therefore, these loans and investments are expected to generate a generally stable return. Our ability to meet our long-term liquidity and capital resource requirements is subject to obtaining additional debt and equity financing. If we are unable to renew our sources of financing on substantially similar terms or at all, it would have an adverse effect on our business and results of operations. Any decision by our lenders and investors to enter into such transactions with us will depend upon a number of factors, such as our financial performance, compliance with the terms of our existing credit arrangements, industry or market trends, the general availability of and rates applicable to financing transactions, such lenders' and investors' resources and policies concerning the terms under which they make such capital commitments and the relative attractiveness of alternative investment or lending opportunities.

To maintain our status as a REIT under the Internal Revenue Code, we must distribute annually at least 90% of our taxable income. These distribution requirements limit our ability to retain earnings and thereby replenish or increase capital for operations. However, we believe that our significant capital resources and access to financing will provide us with financial flexibility and market responsiveness at levels sufficient to meet current and anticipated capital requirements, including expected new lending and investment opportunities.

In order to maximize the return on our funds, cash generated from operations is generally used to temporarily pay down borrowings under credit facilities whose primary purpose is to fund our new loans and investments. When making distributions, we borrow the required funds by drawing on credit capacity available under our credit facilities. To date, all distributions have been funded in this manner. All funds borrowed to make distributions have been repaid by funds generated from operations.

CONTRACTUAL COMMITMENTS

As of December 31, 2004, we had the following material contractual obligations (payments in thousands):

Contractual Obligations	Payments Due by Period ⁽¹⁾				Total
	2005	2006–2007	2008–2009	Thereafter	
Structured transaction facility ⁽⁴⁾	\$ 54,265	\$ 46,962	\$ —	\$ 35,972	\$137,199
Repurchase agreements ⁽⁴⁾	103,346	58,036	16,775	230,953	409,110
Unsecured credit facility ⁽⁴⁾	15,000	—	—	—	15,000
Loan participations ⁽⁴⁾	3,000	10,572	—	—	13,572
Outstanding unfunded commitments ⁽²⁾	4,653	30,067	1,417	—	36,137
Management fee ⁽³⁾	N/A	N/A	N/A	N/A	N/A
Totals	\$180,264	\$145,637	\$18,192	\$266,925⁽⁵⁾	\$611,018

(1) Represents amounts due based on contractual maturities.

(2) In accordance with certain of our loans and investments, we have outstanding unfunded commitments of \$36.1 million as of December 31, 2004, that we are obligated to fund as the borrowers meet certain requirements. Specific requirements include but are not limited to property renovations, building construction, and building conversions based on criteria met by the borrower in accordance with the loan agreements.

(3) This contract does not have fixed and determinable payments; refer to section entitled “Management Agreement” below.

(4) We have contractual obligations to make future payments in connection with short-term and long-term debt described in the section entitled “Liquidity and Capital Resources.”

(5) In connection with the CDO transaction in January 2005, \$36 million of the structured transaction facility scheduled to mature in 2006, \$28 million of the repurchase agreement scheduled to mature in 2005 and \$203 million of the repurchase agreements scheduled to mature in 2006 were repaid. The CDO has a four-year replenishment period.

MANAGEMENT AGREEMENT

Base Management Fees. In exchange for the services that ACM provides us pursuant to the management agreement, we pay our manager a monthly base management fee in an amount equal to:

- (1) 0.75% per annum of the first \$400 million of our operating partnership’s equity (equal the month-end value computed in accordance with GAAP of total partners’ equity in our operating partnership, plus or minus any unrealized gains, losses or other items that do not affect realized net income);
- (2) 0.625% per annum of our operating partnership’s equity between \$400 million and \$800 million; and
- (3) 0.50% per annum of our operating partnership’s equity in excess of \$800 million.

The base management fee is not calculated based on the manager’s performance or the types of assets it selects for investment on our behalf, but it is affected by the performance of these assets because it is based on the value of our operating partnership’s equity. We incurred \$2.0 million and \$0.6 million in base management fees for services rendered in 2004 and the period ended December 31, 2003, respectively.

Incentive Compensation. Pursuant to the management agreement, our manager is also entitled to receive incentive compensation in an amount equal to:

- (1) 25% of the amount by which:
 - (a) our operating partnership’s funds from operations per operating partnership unit, adjusted for certain gains and losses, exceeds
 - (b) the product of (x) the greater of 9.5% per annum or the Ten Year U.S. Treasury Rate plus 3.5%, and (y) the weighted average of (i) \$15.00, (ii) the offering price per share of our common stock (including any shares of common stock issued upon exercise of warrants or options) in any subsequent offerings (adjusted for any prior capital dividends or distributions), and (iii) the issue price per operating partnership unit for subsequent contributions to our operating partnership, multiplied by
- (2) the weighted average of our operating partnership’s outstanding operating partnership units.

In 2004, our manager earned a total of \$1.6 million of incentive compensation and elected to receive it in 66,141 shares of common stock. Our manager did not earn incentive compensation for the period ended December 31, 2003.

We pay the annual incentive compensation in four installments, each within 60 days of the end of each fiscal quarter. The calculation of each installment is based on results for the 12 months ending on the last day of the fiscal quarter for which the installment is payable. These installments of the annual incentive compensation are subject to recalculation and potential reconciliation at the end of such fiscal year. Subject to the ownership limitations in our charter, at least 25% of this incentive compensation is payable to our manager in shares of our common stock having a value equal to the average closing price per share for the last twenty days of the fiscal quarter for which the incentive compensation is being paid.

The incentive compensation is accrued as it is earned. In accordance with Issue 4(b) of EITF 96-18, "Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services," the expense incurred for incentive compensation paid in common stock is determined using the valuation method described above and the quoted market price of our common stock on the last day of each quarter. At December 31 of each year, we remeasure the incentive compensation paid to our manager in the form of common stock in accordance with Issue 4(a) of EITF 96-18 which discusses how to measure at the measurement date when certain terms are not known prior to the measurement date. Accordingly, the expense recorded for such common stock is adjusted to reflect the fair value of the common stock on the measurement date when the final calculation of the annual incentive compensation is determined. In the event that the annual incentive compensation calculated as of the measurement date is less than the four quarterly installments of the annual incentive compensation paid in advance, our manager will refund the amount of such overpayment in cash and we would record a negative incentive compensation expense in the quarter when such overpayment is determined.

Origination Fees. Our manager is entitled to 100% of the origination fees paid by borrowers under each of our bridge loan and mezzanine loans that do not exceed 1% of the loan's principal amount. We retain 100% of the origination fee that exceeds 1% of the loan's principal amount.

Term and Termination. The management agreement has an initial term of two years and is renewable automatically for an additional one year period every year thereafter, unless terminated with six months' prior written notice. If we terminate or elect not to renew the management agreement in

order to manage our portfolio internally, we are required to pay a termination fee equal to the base management fee and incentive compensation for the 12-month period preceding the termination. If, without cause, we terminate or elect not to renew the management agreement for any other reason, including a change of control of us, we are required to pay a termination fee equal to two times the base management fee and incentive compensation paid for the 12-month period preceding the termination.

INFLATION

In our two most recent fiscal years, inflation and changing prices have not had a material effect on our net income and revenue. Changes in the general level of interest rates prevailing in the economy in response to changes in the rate of inflation generally have little effect on our income because most of our interest-earning assets and interest-bearing liabilities have floating rates of interest. However, the value of our interest-earning assets, our ability to realize gains from the sale of assets, and the average life of our interest-earning assets, among other things, may be effected. See "Quantitative and Qualitative Disclosures about Market Risk" below.

RELATED PARTY TRANSACTIONS

Related Party Loans

As of December 31, 2004, we had a \$7.75 million first mortgage loan and as of December 31, 2003, this first mortgage loan had an outstanding principal amount of \$13.5 million and we had a \$1.2 million second mortgage loan, each of which bore interest at a variable rate of one month LIBOR plus 4.25% and matures in March 2005. Each of these loans were made to a not-for-profit corporation that holds and manages investment property from the endowment of a private academic institution. Two of our directors are members of the board of trustees of the borrower under each of these loans and the private academic institution. Interest income recorded from these loans in 2004 and 2003 was approximately \$0.9 million and \$0.4 million, respectively.

ACM has a 50% non-controlling interest in a joint venture, which was formed to acquire, develop and/or sell real estate assets. At December 31, 2004 and 2003, ACM's investment in this joint venture was approximately \$2.6 million. All loans outstanding to this joint venture were repaid in full in 2004. At December 31, 2003, we had a \$16.0 million bridge loan outstanding to the joint venture, which was collateralized by a first lien position on a commercial real

estate property. This loan was funded by ACM in June 2003 and was purchased by us in July 2003. The loan required monthly interest payments based on one month LIBOR and was repaid in full in 2004. We had agreed to provide the borrower with additional mezzanine financing in the amount of up to \$8.0 million. The mezzanine financing required interest payments based on one month LIBOR and was repaid in full in 2004. Interest income recorded from these loans for the period ended December 31, 2004 and 2003 was approximately \$0.8 million and \$0.5 million, respectively.

Our \$16.0 million bridge loan to the joint venture was contributed by ACM as one of the structured finance assets contributed to us on July 1, 2003 at book value, which approximates fair value. At the time of contribution, ACM also agreed to provide a limited guarantee of the loan's principal amount based any profits realized on its retained 50% interest in the joint venture with the borrower and ACM's participating interests in borrowers under three other contributed structured finance assets.

At the time of ACM's origination of three of the structured finance assets that it contributed to us on July 1, 2003 at book value, which approximates fair value, each of the property owners related to these contributed assets granted ACM participating interests that share in a percentage of the cash flows of the underlying properties. Upon contribution of the structured finance assets, ACM retained these participating interests and its 50% non-controlling interest in the joint venture to which it had made the \$16.0 million bridge loan. ACM agreed that if any portion of the outstanding amount of any of these four contributed assets is not paid at its maturity or repurchase date, ACM will pay to us, subject to the limitation described below, the portion of the unpaid amount of the contributed asset up to the total amount then received by ACM due to the realization of any profits on its retained interests associated with any other of the four contributed assets (which had an aggregate balance of \$48.3 million as of December 31, 2003). However, ACM will no longer be obligated to make such payments to us when the

remaining accumulated principal amount of the four contributed assets, collectively, falls below \$5 million and none of the four contributed assets are in default. In 2004, two of these investments matured and the borrowers paid the amount due in full. The remaining two investments have an aggregate balance of \$22.3 million as of December 31, 2004.

As of December 31, 2004, approximately \$0.3 million of interest payments from borrowers due from ACM was included in other assets. These payments were remitted in January 2005. As of December 31, 2004, approximately \$0.6 million of interest reserve payments due to ACM was included in other liabilities. These payments were remitted in January 2005.

In 2003, ACM received a brokerage fee for services rendered in arranging a loan facility for a borrower. A portion of the loan facility was provided by us. We were credited \$0.1 million of this brokerage fee which represented our proportionate share of the loan facility provided to the borrower and is included in other assets at December 31, 2003, which was received in January 2004.

Other Related Party Transactions

ACM contributed the majority of its structured finance portfolio to our operating partnership pursuant to a contribution agreement. The contribution agreement contains representations and warranties concerning the ownership and terms of the structured finance assets it contributed and other customary matters. ACM has agreed to indemnify us and our operating partnership against breaches of those representations and warranties. In connection with its asset contribution ACM has also agreed to guaranty a portion of the principal amount of four contributed assets in which ACM has retained a participating interest or a joint venture interest in the borrower. In 2004, two of these investments matured and the borrowers paid the amounts due in full.

In exchange for ACM's asset contribution, we issued to ACM approximately 3.1 million operating partnership units, each of which ACM may redeem for one share of our common stock or an equivalent amount in cash, at our election,

and approximately 629,000 warrants, each of which entitles ACM to purchase one additional operating partnership unit at an initial exercise price of \$15.00. The operating partnership units and warrants for additional operating partnership units issued to ACM were valued at approximately \$43.9 million at July 1, 2003, based on the price offered to investors in our units in the private placement, adjusted for the initial purchaser's discount. We also granted ACM certain demand and other registration rights with respect to the shares of common stock issuable upon redemption of its operating partnership units. In October 2004, ACM exercised all of its warrants for a total of 629,345 operating partnership units and proceeds of \$9.4 million.

Each of the approximately 3.7 million operating partnership units owned by ACM is paired with one share of our special voting preferred stock that entitles the holder to one vote on all matters submitted to a vote of our stockholders. As operating partnership units are redeemed for shares of our common stock or cash an equivalent number of shares of special voting preferred stock will be redeemed and cancelled. As a result of the ACM asset contribution and the related formation transactions, ACM owns approximately a 19% limited partnership interest in our operating partnership and the remaining 81% interest in our operating partnership is owned by us. In addition, ACM has approximately 19% of the voting power of our outstanding stock.

We and our operating partnership have entered into a management agreement with ACM pursuant to which ACM has agreed to provide us with structured finance investment opportunities and loan servicing as well as other services necessary to operate our business. As discussed above in "—Contractual Commitments," we have agreed to pay our manager an annual base management fee and incentive compensation each fiscal quarter and share with ACM a portion of the origination fees that we receive on loans we originate with ACM pursuant to this agreement.

Under the terms of the management agreement, ACM is also required to provide us with a right of first refusal with respect to all structured finance transactions identified by ACM or its affiliates. We have agreed not to pursue, and to allow ACM to pursue, any real estate opportunities other than structured finance transactions.

In addition, Mr. Kaufman has entered into a non-competition agreement with us pursuant to which he has agreed not to pursue structured finance investment opportunities, except as approved by our board of directors.

We and our operating partnership have also entered into a services agreement with ACM pursuant to which our asset management group provides asset management services to ACM. In the event the services provided by our asset management group pursuant to the agreement exceed by more than 15% per quarter the level of activity anticipated by our board of directors, we will negotiate in good faith with our manager an adjustment to our manager's base management fee under the management agreement, to reflect the scope of the services, the quantity of serviced assets or the time required to be devoted to the services by our asset management group.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS of the Structured Finance Business of Arbor Commercial Mortgage, LLC and Subsidiaries

You should read the following discussion in conjunction with the sections of this report entitled "Risk Factors," "Forward-Looking Statements" and "Selected Consolidated Financial Information of the Structured Finance Business of Arbor Commercial Mortgage, LLC and Subsidiaries" and the historical consolidated financial statements of the structured finance business of Arbor Commercial Mortgage, including related notes, included elsewhere in this report.

OVERVIEW AND BASIS OF PRESENTATION

On July 1, 2003 ACM contributed a portfolio of structured finance investments and related liabilities to our operating partnership. In addition, certain employees of ACM related to its structured finance business became our employees. These assets, liabilities and employees represented a substantial portion of ACM's structured finance business, which historically invested in real estate related bridge and mezzanine loans, preferred equity and other real estate related assets.

The structured finance business of ACM is not a separate legal entity and the assets and liabilities associated with ACM's structured finance business are components of a larger business. We obtained the information in the consolidated financial statements included elsewhere in this report from ACM's consolidated historical accounting records.

The structured finance business of ACM never operated as a separate business segment or division of ACM, but as an integrated part of ACM's consolidated business. Accordingly, the statements of revenue and direct operating expenses do not include charges from ACM for corporate general and administrative expense because ACM considered such items to be corporate expenses and did not allocate them to individual business units. These expenses included costs for ACM's executive management, corporate facilities and overhead costs, corporate accounting and treasury functions, corporate legal matters and other similar costs.

The information in the statements of revenue and direct operating expenses include the revenue and direct operating expenses that relate to the structured finance business. Direct operating expenses include interest expense applicable to the funding costs of the structured finance business loans and investments, salaries and related fringe benefit costs, provision for loan losses and other expenses directly associated with revenue-generating activities. Direct operating expenses also include allocations of certain expenses, such as telephone, office equipment rental and maintenance, office supplies and marketing, which were directly associated with the structured finance business and were allocated based on headcount of the structured finance business in relation to the total headcount of ACM. All of these allocations are based on assumptions that management believes are reasonable under the circumstances.

The consolidated financial statements in this report do not include a statement of cash flows because the structured finance business did not maintain a separate cash balance. Other than the debt required to fund the loans and investments of the structured finance business, operating activities of the structured finance business were funded by ACM.

Since the structured finance business never operated as a separate business division or segment of ACM, the consolidated financial statements included in this report are not intended to be a complete presentation of the historical financial position, results of operations and cash flows of the structured finance business. These consolidated financial statements were prepared for inclusion in this report and do not purport to reflect the financial position or results of operations that would have resulted if the structured finance business had operated as a separate company. The historical consolidated financial information included in this report is not likely to be indicative of our financial position, results of operations or cash flows for any future period. See "Risk Factors—Our historical consolidated financial information is not likely to be indicative of our future performance or financial position as a separate company."

SOURCES OF OPERATING REVENUES

We derive our operating revenues primarily from interest received from making real estate related bridge and mezzanine loans and preferred equity investments. We provide bridge loans secured by first lien mortgages on the property to borrowers who are typically seeking short-term capital to be used in an acquisition of property. The bridge loans we make typically range in size from \$1 million to \$25 million and have terms of up to seven years. We provide real property owners with mezzanine loans that are secured by pledges of ownership interests in entities that directly or indirectly control the real property or second mortgages. These loans typically range in size from \$2 million to \$15 million and have terms of up to seven years. We also make preferred equity investments in entities that directly or indirectly own real property. Interest represented 83% and 93% of total revenue for the six months ended June 30, 2003 and June 30, 2002, respectively. Interest represented 93% and 90% of total revenue for the years ended December 31, 2002 and December 31, 2001, respectively.

We also derive operating revenue from other income that includes several types of income that are recorded upon receipt. Certain of our loans and investments provide for additional payments based on the borrower's operating cash flow, appreciation of the underlying collateral, payments calculated based on timing of when the loan pays off and changes in interest rates. Such amounts are not readily determinable and are recorded as other income upon receipt.

Other income also includes the recognition of deferred revenue on loans that prepay, asset management fees related to our loans and investment portfolio and satisfactions on impaired loans in excess of carrying values. Other income represented 17% and 7% of total revenue for the six months ended June 30, 2003 and June 30, 2002, respectively. Other income represented 7% and 10% of total revenue for the years ended December 31, 2002 and December 31, 2001, respectively.

GAIN ON SALE OF LOANS AND REAL ESTATE AND INCOME FROM EQUITY AFFILIATES

We also derive income from the gain on sale of loans and real estate. We acquire (1) real estate for our own investment and, upon stabilization, disposition at an anticipated return and (2) real estate notes generally at a discount from lenders in situations where the borrower wishes to restructure and reposition its short-term debt and the lender wishes to divest certain assets from its portfolio.

In addition, we derive income from equity affiliates relating to joint ventures that ACM's structured finance business formed with equity partners to lend to, acquire, develop and/or sell real estate assets. These investments are recorded under the equity method. We record our share of net income from the underlying properties invested in through these joint ventures.

SIGNIFICANT ACCOUNTING ESTIMATES AND CRITICAL ACCOUNTING POLICIES

Set forth below is a summary of the accounting policies that management believes are critical to the preparation of the consolidated financial statements included in this report. Certain of the accounting policies used in the preparation of these consolidated financial statements are particularly important for an understanding of the financial position and results of operations presented in the historical consolidated financial statements included in this report and require the application of significant judgment by management and, as a result, are subject to a degree of uncertainty.

Real Estate Owned

Real estate owned represents commercial real estate property that the structured finance business of ACM owns and operates. Such assets are not depreciated and are carried at the lower of cost or fair value less cost to sell. Management reviews its real estate assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

Loans and Investments

Loans held for investment are intended to be held to maturity and, accordingly, are carried at cost, net of unamortized loan origination costs and fees, unless such loan or investment is deemed to be impaired.

ACM's structured finance business historically invested in preferred equity interests that allowed ACM to participate in a percentage of the underlying property's cash flows from operations and proceeds from a sale or refinancing. At the inception of each such investment, management must determine whether such investment should be accounted for as a loan, joint venture or as real estate. To date, management has determined that all such investments are properly accounted for and reported as loans.

Specific valuation allowances are established for impaired loans based on the fair value of collateral on an individual loan basis. The fair value of the collateral is determined by an evaluation of operating cash flow from the property during the projected holding period, and estimated sales value computed by applying an expected capitalization rate to the stabilized net operating income of the specific property, less selling costs, discounted at market discount rates. If upon completion of the valuation, the fair value of the underlying collateral securing the impaired loan is less than the net carrying value of the loan, an allowance is created with a corresponding charge to the provision for loan losses. The allowance for each loan is maintained at a level believed adequate by management to absorb probable losses.

Revenue Recognition

The revenue recognition policies for ACM's structured finance business are as follows:

Interest Income. Interest income is recognized on the accrual basis as it is earned. In most instances, the borrower pays an additional amount of interest at the time the loan is closed, an origination fee, and deferred interest upon maturity of the loan. This additional income as well as any direct loan origination costs incurred, is deferred and recognized over the life of the related loan as a yield adjustment. Income recognition is suspended for loans when in the opinion of management a full recovery of income and principal becomes doubtful. Income recognition is resumed when the loan becomes contractually current and performance is demonstrated to be resumed. Several of the loans provide for accrual of interest at specified rates, which differ from current payment terms. Interest is recognized on such loans at the accrual rate subject to management's determination that accrued interest and outstanding principal are ultimately collectible, based on the underlying collateral and operations of the borrower. If management cannot make this determination regarding collectibility, interest income is recognized only upon actual receipt.

RESULTS OF OPERATIONS

Six Months Ended June 30, 2003 and 2002

Revenue. The following table sets forth the components of revenue:

	Six Months Ended June 30,		Increase	
	2003	2002	Amount	Percent
Interest income	\$7,688,465	\$7,482,750	\$ 205,715	3%
Other income	1,552,414	553,625	998,789	180%
Total revenue	\$9,240,879	\$8,036,375	\$1,204,504	15%

Interest income increased \$0.2 million, or 3%, to \$7.7 million for the six months ended June 30, 2003 from \$7.5 million for the six months ended June 30, 2002. This increase was primarily due to a 21% increase in the weighted average balance of loans and investment partially offset by a 15% decrease in the weighted average effective interest rate of loans and investments primarily due to a decline in market interest rates. Most of our loans and investments are variable rate instruments based on LIBOR. The negative impact to interest income as a result of the decrease in market interest rates was partially offset by interest rate floors that were in effect on many of our loans and investments.

Other income increased \$1.0 million, or 180%, to \$1.6 million for the six months ended June 30, 2003 from \$0.6 million for the six months ended June 30, 2002. This increase was primarily attributable to (a) the partial satisfaction of an impaired loan for an amount \$0.4 million in excess of the loan's carrying value resulting in the recognition of other income for this amount (b) increased funds received on paid-off loans of \$0.3 million and (c) increased accelerated amortization of revenue of \$0.4 million on loans with early payoffs.

Expenses. The following table sets forth the components of direct operating expenses:

	Six Months Ended June 30,		Increase/(Decrease)	
	2003	2002	Amount	Percent
Interest expense	\$3,468,275	\$3,370,777	\$ 97,498	3%
Employee compensation and benefits	1,751,147	1,410,272	340,875	24%
Selling and administrative	458,266	368,253	90,013	24%
Provision for loan losses	60,000	3,195,000	(3,135,000)	(98)%
Total direct operating expenses	\$5,737,688	\$8,344,302	\$(2,606,614)	(31)%

Interest expense increased \$0.1 million, or 3%, to \$3.5 million for the six months ended June 30, 2003 from \$3.4 million for the six months ended June 30, 2002. This increase is primarily attributable to a 26% increase in the weighted average borrowings partially offset by a 19% decrease in the weighted average effective financing rate primarily due to a decline in market interest rates.

Employee compensation and benefits increased \$0.3 million, or 24%, to \$1.8 million for the six months ended June 30, 2003 from \$1.4 million for the six months ended June 30, 2002. This increase reflects increased staffing levels associated with the increased loan and investments opportunities.

Selling and administrative expenses increased \$0.1 million, or 24%, to \$0.5 million for the six months ended June 30, 2003 from \$0.4 million for the six months ended June 30, 2002. This increase was primarily attributable to operating expenses incurred in 2003 for a real estate owned asset, and increased marketing expenses associated with the growth of the lending and investment activities.

Provision for loan losses decreased \$3.1 million, or 98%, to \$0.1 million for the six months ended June 30, 2003 from \$3.2 million for the six months ended June 30, 2002. This decrease was directly attributable to a \$3.1 million provision for loan losses recorded in 2002 prior to this loan being foreclosed and reclassified to real estate owned. This provision was recorded to reflect this asset at its estimated fair value.

Gain on Sale of Loans and Real Estate and Income from Equity Affiliates. The following table sets forth our gain on sale of loans and real estate and income from equity affiliates:

	Six Months Ended June 30,		(Decrease)	
	2003	2002	Amount	Percent
Gain on sale of loans and real estate	\$1,024,268	\$7,006,432	\$(5,982,164)	(85)%
Income from equity affiliates	\$ —	\$ 601,100	\$ (601,100)	—

Gain on sale of loans and real estate decreased \$6.0 million, or 85%, to \$1.0 million for the six months ended June 30, 2003 from \$7.0 million for the six months ended June 30, 2002. This decrease was primarily attributable to a \$6.8 million gain on the sale of a joint venture interest in March 2002 partially offset by a \$0.9 million gain on the partial liquidation of a joint venture interest in 2003.

Income from equity affiliates for the six months ended June 30, 2002 consist of net income from a joint venture interest recognized prior to the sale of that joint venture interest in March 2002.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS of the Structured Finance Business of Arbor Commercial Mortgage, LLC and Subsidiaries (continued)

Years Ended December 31, 2002 and 2001

Revenue. The following table sets forth the components of revenue:

	Year Ended December 31,		(Decrease)	
	2002	2001	Amount	Percent
Interest income	\$14,532,504	\$14,667,916	\$(135,412)	(1)%
Other income	1,090,106	1,668,215	(578,109)	(35)%
Total revenue	\$15,622,610	\$16,336,131	\$(713,521)	(4)%

Interest income decreased \$0.1 million, or 1%, to \$14.5 million for 2002 from \$14.7 million for 2001. This decrease was primarily due to a 16% decrease in the weighted average effective interest rate of loans and investments primarily due to a decline in market interest rates partially offset by a 17% increase in the weighted average balance of loans and investment. Most of our loans and investments are variable rates instruments based on LIBOR. The negative impact to interest income as a result of the decrease in market interest rates was partially offset by interest rate floors that were in effect on many of our loans and investments.

Other income decreased \$0.6 million, or 35%, to \$1.1 million for 2002 from \$1.7 million for 2001. This decrease was primarily attributable to decreased extension fees earned of \$0.2 million and decreased funds received on paid off loans of \$0.4 million.

Expenses. The following table sets forth the components of direct operating expenses:

	Year Ended December 31,		Increase/(Decrease)	
	2002	2001	Amount	Percent
Interest expense	\$ 6,586,640	\$ 7,029,374	\$ (442,734)	(6)%
Employee compensation and benefits	2,827,191	2,888,603	(61,412)	(2)%
Selling and administrative	910,924	839,823	71,101	8%
Provision for loan losses	3,315,000	240,000	3,075,000	1,281%
Total direct operating expenses	\$13,639,755	\$10,997,800	\$2,641,955	24%

Interest expense decreased \$0.4 million, or 6%, to \$6.6 million for 2002 from \$7.0 million for 2001. This decrease is primarily attributable to a 20% decrease in the weighted average effective financing rate due to a decline in market interest rates partially offset by a 17% increase in the weighted average borrowings.

Employee compensation and benefits remained relatively stable from 2001 to 2002.

Selling and administrative expenses increased \$0.1 million, or 8%, to \$0.9 million for 2002 from \$0.8 million for 2001. This increase was primarily attributable to increased legal expenses associated with the asset management and restructuring of our loans and investments portfolio.

Provision for loan losses increased \$3.1 million, or 1,281%, to \$3.3 million for 2002 from \$0.2 million for 2001. This increase was directly attributable to a \$3.1 million provision for possible loan losses recorded in 2002 prior to this loan being foreclosed on and reclassified as real estate owned. This provision was recorded to reflect this asset at its estimated fair value.

Gain on Sale of Loans and Real Estate and Income from Equity Affiliates. The following table sets forth our gain on sale of loans and real estate and income from equity affiliates:

	Year Ended December 31,		Increase/(Decrease)	
	2002	2001	Amount	Percent
Gain on sale of loans and real estate	\$7,470,999	\$3,226,648	\$4,244,351	132%
Income from equity affiliates	\$ 632,350	\$1,403,014	\$ (770,664)	(55)%

Gain on sale of loans and real estate increased \$4.2 million, or 132%, to \$7.5 million for 2002 from \$3.2 million for 2001. This increase was primarily attributable to a \$6.8 million gain on the sale of a joint venture interest in March 2002 partially offset by a \$2.2 million gain from the sale of property from a joint venture interest and a \$0.3 million decrease in income from the sale of foreclosed loans.

Income from equity affiliates decreased \$0.8 million, or 55%, to \$0.6 million for 2002 from \$1.4 million for 2001. This decrease was primarily attributable to a \$0.9 million decrease in net income from joint venture interests due to dissolutions of joint ventures in 2001 and 2002, partially offset by a \$0.1 million increase in net income from other joint venture interest.

PRO FORMA EFFECT OF ARBOR COMMERCIAL MORTGAGE'S ASSET CONTRIBUTION ON RESULTS OF OPERATIONS

We were formed in June 2003 to operate as a real estate investment trust and to expand the structured finance business of ACM. On July 1, 2003, we completed a private placement of our units, each consisting of five shares of our common stock and one warrant to purchase one share of our common stock. Gross proceeds from the private placement totaled \$120.2 million. In exchange for a commensurate equity ownership in our operating subsidiary, ACM contributed \$213.1 million of structured finance assets subject to

\$169.2 million of borrowings supported by \$43.9 million of equity. These assets and liabilities were contributed at book value, which approximates fair value, and represent 88% of the assets and 98% of the liabilities of ACM's structured finance business as of June 30, 2003. In addition, certain employees of ACM were transferred to us.

We are externally managed and advised by ACM and pay ACM a management fee in accordance with the terms of the management agreement. ACM also sources originations, provides underwriting services and services all structured finance assets on our behalf. As a result, the operating expenses as presented in the historical consolidated financial statements of ACM's structured finance business would have been affected had we been formed at an earlier time. Employee compensation and benefits expense would have decreased by \$0.9 million and \$1.5 million for the six months ended June 30, 2003 and year ended December 31, 2002, respectively, because these costs would have been borne by ACM under terms of the management agreement. Similarly, selling and administrative expense would have decreased by \$0.1 million and \$0.1 million for the six months ended June 30, 2003 and year ended December 31, 2002, respectively.

In accordance with the management agreement, we will pay ACM a management fee, composed of a base management fee and incentive compensation. The base management fee is 0.75% per annum of the first \$400 million of equity. The incentive compensation is equal to (1) 25% of the amount that our funds from operations per operating partnership unit, adjusted for certain gains and losses, exceeds the product of (x) 9.5% per annum or the Ten Year U.S. Treasury Rate plus 3.5%, whichever is greater and (y) the weighted average of the book value of the net assets contributed by ACM to our operating partnership per operating partnership unit, the offering price per share in the private placement, the offering price per share of our common stock in subsequent offerings and the issue price per operating partnership unit for subsequent contributions to our operating partnership, multiplied by (2) the weighted average of our operating partnership's outstanding units.

This pro forma information does not reflect the results of the private placement. However, gross proceeds from the private placement totaled \$120.2 million, which combined with ACM's equity contribution of \$43.9 million, resulted in total contributed capital of \$164.1 million. Offering expenses of \$10.1 million were paid or accrued by us, resulting in stockholders' equity and minority interest of \$154.0 million as a result of the private placement.

The pro forma consolidated financial information is limited to adjustments that are directly attributable to the private placement, expected to have a continuing impact on us and are factually supportable. These adjustments are based on the assumption that certain compensation and benefits expenses and certain selling and administrative expenses incurred by the structured finance business of ACM would not have been incurred if we had been in operation during the periods presented. The pro forma financial results do not include what the impact would have been had the gross proceeds from the private placement been available to the structured finance business of ACM during the entire period. Had these proceeds been available to the structured finance business of ACM during the entire period, there would have been an impact on certain revenues and expenses, including the management fees payable pursuant to the management agreement. The management fees are calculated based on such factors as funds from operations and equity of our operating partnership, each as defined in the management agreement. Such amounts represent speculative and forward-looking information that is not factually supportable.

The financial statements of the structured finance business of ACM include the results of operations of the structured finance business segment of ACM and are not limited to the results of the structured finance assets that were transferred to Arbor Realty Trust. Accordingly, the results of certain investments in equity affiliates that were not transferred to Arbor Realty Trust have been included in the financial statements of the structured finance business of ACM because they were included in the structured finance business segment even though the operating results from these equity affiliates have not been material to the structured finance business segment as a whole. In addition, ACM retained certain transactions in its structured finance portfolio with a net book value of approximately \$27.8 million, primarily because they were not deemed to be suitable investments for Arbor Realty Trust. Had these retained assets been excluded from the financial statements of the structured finance business of ACM, additional adjustments to the expense base would have been necessary to estimate what expenses would have been had these assets not been in the portfolio. Such adjustments would have been speculative. Lastly, operating results for assets that matured before the contribution of structured finance assets to Arbor Realty Trust, but were in the portfolio of assets of the structured finance business of ACM during the reporting period are also included in these statements.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity is a measurement of the ability to meet potential cash requirements, including ongoing commitments to repay borrowings, fund and maintain loans and investments and other general business needs. On July 1, 2003, ACM contributed a portfolio of structured finance investments and related liabilities to our operating partnership. In addition, certain employees of ACM became our employees. These assets, liabilities and employees represented a substantial portion of the structured finance business of ACM.

On July 1, 2003, we completed the private placement, resulting in gross proceeds of \$120.2 million. Gross proceeds from the private placement combined with the concurrent equity contribution by ACM totaled approximately \$164.1 in equity capital.

Subsequent to and as a result of the private placement, substantially all of the operations of the structured finance business of ACM have been conducted by us. Therefore, a description of the liquidity and capital resources of the structured finance business of ACM is not presented. A description of our liquidity and capital resources is presented in the section of this report entitled "Management's Discussion & Analysis of Financial Condition and Results of Operations of Arbor Realty Trust, Inc. and Subsidiaries—Liquidity and Capital Resources."

RELATED PARTY TRANSACTIONS

Related Party Loans

ACM has a 50% non-controlling interest in a joint venture, which was formed to acquire, develop and/or sell real estate assets. At June 30, 2003, December 31, 2002 and 2001, ACM's structured finance business' investments in this joint venture were approximately \$2.6 million, \$2.3 million and \$1.8 million, respectively. This investment is accounted for under the equity method. At June 30, 2003 and December 31, 2002, ACM had a \$16.0 million bridge loan outstanding to the joint venture, which is collateralized by a first lien position on a commercial real estate property. There is a limited guarantee on the loan of 50% by the chief executive officer of ACM and 50% by the key principal of the joint venture. The loan requires monthly interest payments based on one month LIBOR and matures in May 2006. ACM agreed to provide the borrower with additional mezzanine financing in the amount of up to \$8.0 million. The mezzanine financing requires interest payments based on one month LIBOR and matures in May 2006. The loan will be funded in two equal installments of \$4.0 million. The funding will be drawn down as construction progresses. The

interest on the first component, which was funded by ACM in June 2003, will be earned on the full \$4.0 million, while the interest on the second component, which has yet to be funded, will be earned as the \$4.0 million is drawn down. This additional financing is secured by a second mortgage lien on the property. In addition, an interest and renovation reserve totaling \$2.5 million is in place to cover both the bridge and mezzanine loans. Interest income recorded from these loans was approximately \$0.2 million, \$0.4 million and \$0.1 million for the periods ended June 30, 2003, December 31, 2002 and 2001, respectively.

In June 2003, ACM invested approximately \$0.8 million in exchange for a 12.5% non-controlling interest in a joint venture, which were formed to acquire, develop and/or sell real estate assets. This investment is accounted for under the equity method. In June, 2003, ACM made two mezzanine loans secured by a second lien position in the ownership interests of the borrower and the property to these joint ventures totaling \$6.0 million outstanding. The loans require monthly interest payments based on one month LIBOR and mature in May 2006. Interest income recorded from these loans was approximately \$8,000 for the period ended June 30, 2003.

Related Party Formation Transactions

ACM contributed the majority of its structured finance portfolio to our operating partnership pursuant to a contribution agreement. The contribution agreement contains representations and warranties concerning the ownership and terms of the structured finance assets it contributed and other customary matters. ACM has agreed to indemnify us and our operating partnership against breaches of those representations and warranties.

In exchange for ACM's asset contribution, we issued to ACM approximately 3.1 million operating partnership units, each of which ACM may redeem for one share of our common stock or an equivalent amount in cash, at our election, and approximately 629,000 warrants, each of which entitles ACM to purchase one additional operating partnership unit at an initial exercise price of \$15.00. The operating partnership units and warrants for additional operating partnership units issued to ACM were valued at approximately \$43.9 million at July 1, 2003, based on the price offered to investors in our units in the private placement, adjusted for the initial purchaser's discount. We have also granted ACM certain demand and other registration rights with respect to the shares of common stock issuable upon redemption of its operating partnership units.

Each of the approximately 3.1 million operating partnership units received by ACM was paired with one share of our special voting preferred stock that entitles the holder to one vote on all matters submitted to a vote of our stockholders. As operating partnership units were redeemed for shares of our common stock or cash an equivalent number of shares of special voting preferred stock was redeemed and cancelled. As a result of ACM's asset contribution and the related formation transactions, ACM owns approximately a 28% limited partnership interest in our operating partnership and the remaining 72% interest in our operating partnership is owned by us. In addition, ACM has approximately 28% of the voting power of our outstanding stock (without giving effect to the exercise of ACM's warrants for additional operating partnership units).

We and our operating partnership have entered into a management agreement with ACM pursuant to which ACM has agreed to provide us with structured finance investment opportunities and loan servicing as well as other services necessary to operate our business. ACM is also required to provide us with a right of first refusal with respect to all structured finance identified by ACM or its affiliates. We have agreed not to pursue, and to allow ACM to pursue, any real estate opportunities other than structured finance transactions. As discussed above in "Management's Discussion & Analysis of Financial Condition and Results of Operations of Arbor Realty Trust, Inc. and Subsidiaries—Contractual Commitments," we have agreed to pay our manager an annual base management fee and incentive compensation each fiscal quarter and share with ACM a portion of the origination fees that we receive on loans we originate with ACM pursuant to this agreement.

We and our operating partnership have also entered into a services agreement with ACM pursuant to which our asset management group provides asset management services to ACM. In the event the services provided by our asset management group pursuant to the agreement exceed by more than 15% per quarter the level of activity anticipated by our board of directors, we will negotiate in good faith with our manager an adjustment to our manager's base management fee under the management agreement, to reflect the scope of the services, the quantity of serviced assets or the time required to be devoted to the services by our asset management group.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Since the consummation of the private placement and the related formation transactions, substantially all of the operations of the structured finance business of ACM have been conducted by us. Therefore, quantitative and qualitative disclosures about market risk relating to the structured finance

business of ACM is not presented. A description of market risks relating to our business is presented in this Item 7A of this report under "Quantitative and Qualitative Disclosures about Market Risk."

Market risk is the exposure to loss resulting from changes in interest rates, foreign currency exchange rates, commodity prices, equity prices and real estate values. The primary market risks that we are exposed to are real estate risk, interest rate risk, market value risk and prepayment risk.

Real Estate Risk

Commercial mortgage assets may be viewed as exposing an investor to greater risk of loss than residential mortgage assets since such assets are typically secured by larger loans to fewer obligors than residential mortgage assets. Multi-family and commercial property values and net operating income derived from such properties are subject to volatility and may be affected adversely by a number of factors, including, but not limited to, national, regional and local economic conditions (which may be adversely affected by industry slowdowns and other factors), local real estate conditions (such as an oversupply of housing, retail, industrial, office or other commercial space); changes or continued weakness in specific industry segments; construction quality, age and design; demographic factors; retroactive changes to building or similar codes; and increases in operating expenses (such as energy costs). In the event net operating income decreases, a borrower may have difficulty repaying our loans, which could result in losses to us. In addition, decreases in property values reduce the value of the collateral and the potential proceeds available to a borrower to repay our loans, which could also cause us to suffer losses. Even when the net operating income is sufficient to cover the related property's debt service, there can be no assurance that this will continue to be the case in the future.

Interest Rate Risk

Interest rate risk is highly sensitive to many factors, including governmental monetary and tax policies, domestic and international economic and political considerations and other factors beyond our control.

Our operating results will depend in large part on differences between the income from our loans and our borrowing costs. Most of our loans and borrowings are variable-rate instruments, based on LIBOR. The objective of this strategy is to minimize the impact of interest rate changes on our net interest income. Many of our loans and borrowings are subject to various interest rate floors. As a result, the impact of a change in interest rates may be different on our interest income than it is on our interest expense. Based on the loans and liabilities as of December 31, 2004, and assuming the balances of these loans and liabilities remain unchanged for the subsequent twelve months, a 1% increase in LIBOR

would increase our annual net income and cash flows by approximately \$2.3 million because the principal amount of loans that would be subject to an interest rate adjustment under this scenario is greater than the amount of liabilities that would be subject to an interest rate adjustment. A 1% decrease in LIBOR would decrease our annual net income and cash flows by approximately \$1.7 million because the principal amount of loans exceeds the amount of liabilities partially offset by the fact that the principal amount of loans currently subject to interest rate floors (and, therefore, would not be subject to a downward interest rate adjustment) exceeds the amount of liabilities currently subject to interest rate floors. As the size of the portfolio increases, a decline in interest rates may have a negative impact on our net income.

In the event of a significant rising interest rate environment and/or economic downturn, defaults could increase and result in credit losses to us, which could adversely affect our liquidity and operating results. Further, such delinquencies or defaults could have an adverse effect on the spreads between interest-earning assets and interest-bearing liabilities.

We invest in securities, which are designated as available-for-sale. These securities are adjustable rate securities that have a fixed component for three years and, thereafter, generally reset annually. These securities are financed with a repurchase agreement that bears interest at a rate of one month LIBOR plus .15%. Since the repricing of the debt obligations occurs more quickly than the repricing of the securities, on average our cost of borrowings will rise more quickly in response to an increase in market interest rates than the earnings rate on the securities. This will result in a reduction in our net interest income and cash flows related to these securities. Based on the securities and borrowings as of December 31, 2004, and assuming the balances of these securities and borrowings remain unchanged for the subsequent twelve months, a 1% increase in LIBOR would reduce our annual net income and cash flows by approximately \$0.4 million. A 1% decrease in LIBOR would increase our annual net income and cash flows by approximately \$0.4 million.

In connection with the CDO described in "Management's Discussion and Analysis of Financial Condition and Results of Operations of Arbor Realty Trust, Inc. and Subsidiaries," the Company entered into two interest rate swap agreements to hedge its exposure to the risk of changes in the difference between three-month LIBOR and one-month LIBOR interest rates. These interest rate swaps became necessary due to the investor's return being paid based on a three-month LIBOR index while the assets contributed to the CDO are yielding interest based on a one-month LIBOR index.

These swaps were executed on December 21, 2004 with a notional amount of \$469 million and expire in January 2012. The market value of these interest rate swaps is dependent upon existing market interest rates and swap spreads, which

change over time. If there were a 50 basis point decrease in forward interest rates, the value of these interest rate swaps would have increased by approximately \$21,000. If there were a 50 basis point increase in forward interest rates, the value of these interest rate swaps would have decreased by approximately \$25,000 at December 31, 2004.

Our hedging transactions using derivative instruments also involve certain additional risks such as counterparty credit risk, the enforceability of hedging contracts and the risk that unanticipated and significant changes in interest rates will cause a significant loss of basis in the contract. The counterparties to our derivative arrangements are major financial institutions with high credit ratings with which we and our affiliates may also have other financial relationships. As a result, we do not anticipate that any of these counterparties will fail to meet their obligations. There can be no assurance that we will be able to adequately protect against the foregoing risks and will ultimately realize an economic benefit that exceeds the related amounts incurred in connection with engaging in such hedging strategies.

We utilize interest rate swaps to limit interest rate risk. Derivatives are used for hedging purposes rather than speculation. We do not enter into financial instruments for trading purposes.

Market Value Risk

Our available-for-sale securities are reflected at their estimated fair value with unrealized gains and losses excluded from earnings and reported in other comprehensive income pursuant to SFAS No. 115 "Accounting for Certain Investments in Debt and Equity Securities." The estimated fair value of these securities fluctuate primarily due to changes in interest rates and other factors; however, given that these securities are guaranteed as to principal and/or interest by an agency of the U.S. Government, such fluctuations are generally not based on the creditworthiness of the mortgages securing these securities. Generally, in a rising interest rate environment, the estimated fair value of these securities would be expected to decrease; conversely, in a decreasing interest rate environment, the estimated fair value of these securities would be expected to increase.

Prepayment Risk

As we receive repayments of principal on these securities, premiums paid on such securities are amortized against interest income using the effective yield method through the expected maturity dates of the securities. In general, an increase in prepayment rates will accelerate the amortization of purchase premiums, thereby reducing the interest income earned on the securities.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and stockholders of
Arbor Realty Trust, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of Arbor Realty Trust, Inc. and Subsidiaries (the "Company") as of December 31, 2004 and 2003, and the related consolidated statements of income, stockholders' equity, and cash flows for the year ended December 31, 2004 and for the period from June 24, 2003 (Inception) to December 31, 2003. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Arbor Realty Trust, Inc. and Subsidiaries at December 31, 2004 and 2003, and the consolidated results of their operations and their cash flows for the year ended December 31, 2004 and for the period from June 24, 2003 (Inception) to December 31, 2003, in conformity with U.S. generally accepted accounting principles.

Ernst + Young LLP

New York, New York

February 28, 2005

except for Note 16, as to which the date is March 29, 2005

CONSOLIDATED BALANCE SHEETS

	December 31, 2004	December 31, 2003
Assets:		
Cash	\$ 6,401,701	\$ 6,115,525
Loans and investments, net	831,783,364	286,036,610
Related party loans, net	7,749,538	35,940,881
Available-for-sale securities, at fair value	46,582,592	—
Investment in equity affiliates	5,254,733	5,917,542
Other assets	14,523,249	4,153,874
Total assets	\$912,295,177	\$338,164,432
Liabilities and Stockholders' Equity:		
Repurchase agreements	\$409,109,372	\$113,897,845
Notes payable	165,771,447	58,630,626
Due to borrowers	8,587,070	8,409,945
Other liabilities	5,824,384	2,478,300
Total liabilities	589,292,273	183,416,716
Minority interest	60,249,731	43,631,602
Stockholders' equity:		
Preferred stock, \$0.01 par value: 100,000,000 shares authorized; 3,776,069 and 3,146,724 shares issued and outstanding as of December 31, 2004 and 2003, respectively	37,761	31,467
Common stock, \$0.01 par value: 500,000,000 shares authorized; 16,467,218 and 8,199,567 shares issued and outstanding as of December 31, 2004 and 2003, respectively	164,672	81,996
Additional paid-in capital	254,427,982	112,215,649
Retained earnings (distribution in excess of earnings)	8,813,138	(691,865)
Deferred compensation	(160,780)	(521,133)
Accumulated other comprehensive loss	(529,600)	—
Total stockholders' equity	262,753,173	111,116,114
Total liabilities and stockholders' equity	\$912,295,177	\$338,164,432

See notes to consolidated financial statements.

CONSOLIDATED INCOME STATEMENTS

	For the Year Ended December 31, 2004	Period June 24, 2003 (Inception) to December 31, 2003
Revenue:		
Interest income	\$57,927,230	\$10,012,449
Other income	42,265	156,502
Total revenue	57,969,495	10,168,951
Expenses:		
Interest expense	19,372,575	1,669,731
Employee compensation and benefits	2,325,727	940,336
Stock-based compensation	324,343	1,721,367
Selling and administrative	1,908,522	533,697
Management fee—related party	3,614,830	587,734
Total expenses	27,545,997	5,452,865
Income before minority interest and income from equity affiliates	30,423,498	4,716,086
Income from equity affiliates	525,000	—
Income before minority interest	30,948,498	4,716,086
Income allocated to minority interest	5,875,816	1,308,167
Net income	\$25,072,682	\$ 3,407,919
Basic earnings per common share	\$ 1.81	\$ 0.42
Diluted earning per common share	\$ 1.78	\$ 0.42
Dividends declared per common share	\$ 1.16	\$ 0.50
Weighted average number of shares of common stock outstanding:		
Basic	13,814,199	8,199,567
Diluted	17,366,015	11,346,291

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY FOR THE PERIOD
JUNE 24, 2003 (INCEPTION) TO DECEMBER 31, 2003 AND FOR THE YEAR ENDED
DECEMBER 31, 2004

	Comprehensive Income	Preferred Stock Shares	Preferred Stock Par Value	Common Stock Shares	Common Stock Par Value	Additional Paid-in Capital	Retained Earnings (Distributions in Excess of Earnings)	Deferred Compensation	Accumulated Other Comprehensive Loss	Total
Initial capitalization		—	\$ —	67	\$ 1	\$ 1,004	\$ —	\$ —	\$ —	\$ 1,005
Issuance of preferred stock		3,146,724	31,467							31,467
Issuance of common stock, net				8,050,000	81,980	109,972,160				110,054,140
Deferred compensation				149,500	15	2,242,485		(2,242,500)		—
Stock-based compensation								1,721,367		1,721,367
Distributions— common stock							(4,099,784)			(4,099,784)
Net income	\$ 3,407,919						3,407,919			3,407,919
Balance— December 31, 2003	\$ 3,407,919	3,146,724	\$ 31,467	8,199,567	\$ 81,996	\$ 112,215,649	\$ (691,865)	\$ (521,133)	\$ —	\$ 111,116,114
Issuance of preferred stock		629,345	6,294							6,294
Issuance of common stock, net				7,274,200	72,742	134,115,399				134,188,141
Issuance of common stock from warrant exercise				973,354	9,733	12,862,937				12,872,670
Issuance of common stock from incentive compensation				22,498	225	499,234				499,459
Stock-based compensation								324,343		324,343
Distributions— common stock							(15,567,679)			(15,567,679)
Forfeited unvested restricted stock				(2,401)	(24)	(35,986)		36,010		—
Adjustment to minority interest from increased ownership in ARLP						(5,229,251)				(5,229,251)
Net income	25,072,682						25,072,682			25,072,682
Net unrealized loss on securities available-for-sale	(529,600)								(529,600)	(529,600)
Balance— December 31, 2004	\$ 24,543,082	3,776,069	\$ 37,761	16,467,218	\$ 164,672	\$ 254,427,982	\$ 8,813,138	\$ (160,780)	\$ (529,600)	\$ 262,753,173

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Year Ended December 31, 2004	Period June 24, 2003 (Inception) to December 31, 2003
Operating activities:		
Net income	\$ 25,072,682	\$ 3,407,919
Adjustments to reconcile net income to cash provided by operating activities		
Stock-based compensation	324,343	1,721,367
Minority interest	5,875,816	1,308,167
Amortization and accretion of interest	(1,431,146)	(553,990)
Non-cash incentive compensation to manager	1,623,106	—
Income from equity affiliates	(525,000)	—
Changes in operating assets and liabilities:		
Others assets	(6,192,238)	(2,405,470)
Other liabilities	2,163,060	1,717,467
Deferred origination fees	1,163,039	627,734
Net cash provided by operating activities	28,073,662	5,823,194
Investing activities:		
Loans and investments originated and purchased, net	(733,136,181)	(186,382,155)
Payoffs and paydowns of loans and investments	221,425,780	75,940,655
Due to borrowers	177,125	8,409,945
Securities available-for-sale	(57,228,552)	—
Prepayments on securities available-for-sale	9,722,630	—
Contributions to equity affiliates	(9,562,190)	(5,917,542)
Distributions from equity affiliates	3,525,000	—
Net cash used in investing activities	(565,076,338)	(107,949,097)
Financing activities:		
Proceeds from notes payable and repurchase agreements	605,600,178	71,047,671
Payoffs and paydowns of notes payable and repurchase agreements	(203,247,830)	(67,699,042)
Issuance of common stock	158,356,670	120,200,978
Exercise of warrants from minority interest	9,440,175	31,467
Offering expenses paid	(11,236,483)	(9,385,000)
Distributions paid to minority interest	(3,920,819)	(1,573,362)
Distributions paid on common stock	(15,567,679)	(4,099,784)
Payment of deferred financing costs	(2,135,360)	(281,500)
Net cash provided by financing activities	537,288,852	108,241,428
Net increase in cash	286,176	6,115,525
Cash at beginning of period	6,115,525	—
Cash at end of period	\$ 6,401,701	\$ 6,115,525
Supplemental cash flow information:		
Cash used to pay interest	\$ 18,547,842	\$ 1,378,637
Supplemental schedule of non-cash financing and investing activities:		
Accrued offering expenses	\$ 59,377	\$ 760,833
Conversion of investment in equity affiliates to loan	\$ 6,700,000	\$ —
Loans and investments, net contributed	\$ —	\$ 213,076,639
Notes payable and repurchase agreements contributed	\$ —	\$ 169,179,843

See notes to consolidated financial statements.

December 31, 2004

NOTE 1—DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION

Arbor Realty Trust, Inc. (the “Company”) is a Maryland corporation that was formed in June 2003 to invest in real estate related bridge and mezzanine loans, preferred equity and, in limited cases, mortgage backed securities, discounted mortgage notes and other real estate related assets. The Company has not invested in any discounted mortgage notes for the periods presented. The Company conducts substantially all of its operations through its operating partnership, Arbor Realty Limited Partnership (“ARLP”).

On July 1, 2003 Arbor Commercial Mortgage, LLC (“ACM”) contributed \$213.1 million of structured finance assets and \$169.2 million of borrowings supported by \$43.9 million of equity in exchange for a commensurate equity ownership in ARLP. In addition, certain employees of ACM were transferred to ARLP. These assets, liabilities and employees represent a substantial portion of ACM’s structured finance business (the “SF Business”). The Company is externally managed and advised by ACM and pays ACM a management fee in accordance with a management agreement. ACM also sources originations, provides underwriting services and services all structured finance assets on behalf of ARLP.

On July 1, 2003 the Company completed a private equity offering of units, each consisting of five shares of common stock and one warrant to purchase one share of common stock. Gross proceeds from the private equity offering totaled \$120.2 million. Gross proceeds from the private equity offering combined with the concurrent equity contribution by ACM totaled approximately \$164.1 million in equity capital. The Company paid and accrued offering expenses of \$10.1 million resulting in stockholders’ equity and minority interest of \$154.0 million as a result of the private placement.

On April 13, 2004 the Company sold 6,750,000 shares of its common stock in a public offering at a price to the public of \$20.00 per share, for net proceeds of approximately \$124.4 million after deducting the underwriting discount and the other estimated offering expenses. The Company used the proceeds to pay down indebtedness. After giving effect to this offering, the Company had 14,949,567 shares of common stock outstanding. In addition, on May 6, 2004, the underwriters exercised a portion of their over-allotment option, which resulted in the issuance of 524,200 additional shares on May 11, 2004. The Company received net proceeds of approximately \$9.8 million after deducting the underwriting discount. Additionally, in 2004, 2,401 shares of unvested restricted stock were forfeited. On November 3, 2004, ACM, the manager of our company, elected to be paid its third quarter incentive management in shares of common stock

totaling 22,498. Additionally, as of December 31, 2004, the Company issued 973,354 shares of common stock from the exercise of warrants under its Warrant Agreement dated July 1, 2003 (the “Warrant Agreement”). After giving effect to this, the Company had 16,467,218 shares issued and outstanding.

The accompanying consolidated financial statements include the financial statements of the Company, its wholly-owned subsidiaries, and partnerships or other joint ventures in which the Company controls. Entities which we do not control and entities which are variable interest entities (see Note 2), which we are not the primary beneficiaries, are accounted for under the equity method. All significant inter-company transactions and balances have been eliminated.

NOTE 2 —SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES*Use of Estimates*

The preparation of consolidated financial statements in conformity with U.S. Generally Accepted Accounting Principles (“GAAP”) requires management to make estimates and assumptions in determining the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Reclassifications

Certain prior year amounts have been reclassified to conform to current period presentation.

Cash and Cash Equivalents

All highly liquid investments with original maturities of three months or less are considered to be cash equivalents. The Company places its cash and cash equivalents in high quality financial institutions. The consolidated account balances at each institution periodically exceed FDIC insurance coverage and the Company believes that this risk is not significant.

Loans and Investments

SFAS No. 115 requires that at the time of purchase, we designate a security as held to maturity, available-for-sale, or trading depending on ability and intent. Securities held for sale are reported at fair value, while securities and investments held to maturity are reported at amortized cost. We do not have a trading security at this time. Loans held for investment are intended to be held to maturity and, accordingly, are carried at cost, net of unamortized loan origination costs and fees, unless such loan or investment is deemed to be impaired.

The Company invests in preferred equity interests that, in some cases, allow the Company to participate in a percentage of the underlying property's cash flows from operations and proceeds from a sale or refinancing. At the inception of each such investment, management must determine whether such investment should be accounted for as a loan, joint venture or as real estate. To date, management has determined that all such investments are properly accounted for and reported as loans.

Specific valuation allowances are established for impaired loans based on the fair value of collateral on an individual loan basis. The fair value of the collateral is determined by an evaluation of operating cash flow from the property during the projected holding period, and estimated sales value computed by applying an expected capitalization rate to the stabilized net operating income of the specific property, less selling costs, discounted at market discount rates. As of December 31, 2004 and 2003, no impairment has been identified and no valuation allowances have been established.

If upon completion of the valuation, the fair value of the underlying collateral securing the impaired loan is less than the net carrying value of the loan, an allowance is created with a corresponding charge to the provision for loan losses. An allowance for each loan would be maintained at a level believed adequate by management to absorb probable losses.

Available-for-Sale Securities

The Company invests in agency-sponsored whole pool mortgage-related securities. Pools of Federal National Mortgage Association ("FNMA") and Federal Home Loan Mortgage Corporation ("FHLMC") adjustable rate residential mortgage loans underlie these mortgage-related securities. The Company receives payments from the payments that are made on these underlying mortgage loans, which have a fixed rate of interest for three years and adjust annually thereafter. These securities are carried at their estimated fair value with unrealized gains and losses excluded from earnings and reported in other comprehensive income pursuant to SFAS No. 115 "Accounting for Certain Investments in Debt and Equity Securities." Unrealized losses other than temporary losses are recognized currently in income. The estimated fair value of these securities fluctuate primarily due to changes in interest rates and other factors; however, given that these securities are guaranteed as to principal and/or interest by an agency of the U.S. Government, such fluctuations are generally not based on the creditworthiness of the mortgages securing these securities.

Revenue Recognition

Interest Income—Interest income is recognized on the accrual basis as it is earned on loans, investments and available-for-sale securities. In some instances, the Company receives an additional amount of interest at the time the loan is

closed, an origination fee, and deferred interest upon maturity. In some cases, interest income may also include the amortization or accretion of premiums and discounts arising at the purchase or origination. This additional income, net of any direct loan origination costs incurred, is deferred and accreted into interest income on an effective yield or "interest" method adjusted for actual prepayment activity over the life of the related loan or available-for-sale security as a yield adjustment. Income recognition is suspended for loans when in the opinion of management a full recovery of income and principal becomes doubtful. Income recognition is resumed when the loan becomes contractually current and performance is demonstrated to be resumed. Several of the loans provide for accrual of interest at specified rates, which differ from current payment terms. Interest is recognized on such loans at the accrual rate subject to management's determination that accrued interest and outstanding principal are ultimately collectible, based on the underlying collateral and operations of the borrower. If management cannot make this determination regarding collectibility, interest income is recognized only upon actual receipt. Additionally, interest income is recorded when earned from equity participation interests, referred to as equity kickers. These equity kickers have the potential to generate additional revenues to the Company as a result of excess cash flows being distributed and/or as appreciated properties are sold or refinanced.

Other Income—Other income represents fees received for loan structuring and miscellaneous asset management fees associated with the Company's loans and investments portfolio.

Gain on Sale of Loans and Real Estate

For the sale of loans and real estate, recognition occurs when all the incidence of ownership passes to the buyer.

Income from Equity Affiliates

The Company invests in joint ventures that are formed to acquire, develop and/or sell real estate assets. Such investments are recorded under the equity method. The Company records its share of the net income from the underlying properties.

Other Comprehensive Income (Loss)

SFAS No. 130, "Reporting Comprehensive Income," divides comprehensive income into net income and other comprehensive income (loss), which includes unrealized gains and losses on available-for-sale securities.

Income Taxes

The Company is organized and conducts its operations to qualify as a real estate investment trust ("REIT") and to comply with the provisions of the Internal Revenue Code with respect thereto. A REIT is generally not subject to federal income tax on that portion of its REIT taxable income ("Taxable Income") which is distributed to its stockholders,

December 31, 2004

provided that at least 90% of Taxable Income is distributed and provided that certain other requirements are met. Certain assets of the Company that produce non-qualifying income may be held in taxable REIT subsidiaries. Unlike other subsidiaries of a REIT, the income of a taxable REIT subsidiary is subject to federal and state income taxes. As the taxable REIT subsidiaries of the Company have had minimal activity since their inception, the Company has determined that no provision for income taxes is necessary at this time.

Earnings Per Share

In accordance with the Statement of Financial Accounting standards No. 128 ("SFAS No. 128"), the Company presents both basic and diluted earnings per share. Basic earnings per share excludes dilution and is computed by dividing net income available to common stockholders by the weighted average number of shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock, where such exercise or conversion would result in a lower earnings per share amount.

Derivatives and Hedging Activities

We account for derivative financial instruments in accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities." SFAS No. 133 requires an entity to recognize all derivatives as either assets or liabilities in the consolidated balance sheets and to measure those instruments at fair value. Additionally, the fair value adjustments will affect either shareholders' equity or net income depending on whether the derivative instrument qualifies as a hedge for accounting purposes and, if so, the nature of the hedging activity.

In the normal course of business, we may use a variety of derivative financial instruments to manage, or hedge, interest rate risk. These derivative financial instruments must be effective in reducing its interest rate risk exposure in order to qualify for hedge accounting. When the terms of an underlying transaction are modified, or when the underlying hedged item ceases to exist, all changes in the fair value of the instrument are marked-to-market with changes in value included in net income for each period until the derivative instrument matures or is settled. Any derivative instrument used for risk management that does not meet the hedging criteria is marked-to-market with the changes in value included in net income.

Derivatives are used for hedging purposes rather than speculation. We rely on quotations from a third party to determine these fair values.

Recently Issued Accounting Pronouncements

In January 2003, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46"), which requires a variable interest entity ("VIE") to be consolidated by its primary beneficiary ("PB"). The PB is the party that absorbs a majority of the VIE's anticipated losses and/or a majority of the expected returns.

In December 2003, the FASB revised FIN 46 ("FIN 46(R)"), delaying the effective date for certain entities created before February 1, 2003 and making other amendments to clarify the application of the guidance. FIN 46(R) is effective no later than the end of the first interim or annual period ending after December 15, 2003 for entities created after January 31, 2003 and for entities created before February 1, 2003, no later than the end of the first interim or annual period ending after March 15, 2004. As required, the Company adopted the guidance of FIN 46(R) accordingly.

In adopting FIN 46 and FIN 46(R), the Company has evaluated its loans and investments and investments in equity affiliates to determine whether they are VIEs. This evaluation resulted in the Company determining that its mezzanine loans, preferred equity investments and investments in equity affiliates were potential variable interests. For each of these investments, the Company has evaluated (1) the sufficiency of the fair value of the entities' equity investments at risk to absorb losses, (2) that as a group the holders of the equity investments at risk have (a) the direct or indirect ability through voting rights to make decisions about the entities' significant activities, (b) the obligation to absorb the expected losses of the entity and their obligations are not protected directly or indirectly, (c) the right to receive the expected residual return of the entity and their rights are not capped, (3) the voting rights of these investors are proportional to their obligations to absorb the expected losses of the entity, their rights to receive the expected returns of the equity, or both, and (4) that substantially all of the entities' activities do not involve or are not conducted on behalf of an investor that has disproportionately few voting rights. As of December 31, 2004, the Company has identified four loans and investments which were made to entities determined to be VIEs. The following is a summary of the identified VIEs as of December, 31, 2004.

Type	Carrying Amount	Property	Location
Loan and investment	\$46,500,000	Office	New York
Loan and investment	44,533,333	Retail	Various
Loan	23,272,420	Condo	New York
Loan	7,749,538	Multifamily	Indiana

For the four VIEs identified, the Company has determined that they are not the primary beneficiaries of the VIEs and as such the VIEs should not be consolidated in the Company's financial statements. For all other investments the Company has determined they are not VIEs. As such, the Company has continued to account for these loans and investments as a loan or joint venture, as appropriate.

On March 9, 2004, the SEC released SAB 105, "Application of Accounting Principles to Loan Commitments," providing guidance on how to account for a commitment to purchase a mortgage loan prior to funding the loan. SAB 105 requires that these commitments be recorded at fair value with changes in fair value recognized in current earnings and was intended to eliminate the diversity in industry practice that existed relating to the accounting for loan commitments. SAB 105 is effective for loan commitments entered into after March 31, 2004. Our method of accounting for loan commitments is consistent with the guidance provided by SAB 105.

In December 2003, the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants issued SOP 03-3, "Accounting for Certain Loans or Debt Securities Acquired in a Transfer." SOP 03-3 addresses the accounting for acquired impaired loans, which are loans that show evidence of having deteriorated in terms of credit quality since their origination. SOP 03-3 is effective for loans acquired after December 31, 2004. We do not expect the adoption of SOP 03-3 to have a material effect on our financial condition, results of operations, or liquidity.

In June 2004, the FASB issued EITF 03-01, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments." EITF 03-01 requires an investor

to determine when an investment is considered impaired, evaluate whether that impairment is other than temporary, and, if the impairment is other than temporary, recognize an impairment loss equal to the difference between the investment's cost and its fair value. The guidance also includes accounting considerations subsequent to the recognition of an other-than-temporary impairment and requires certain disclosures about unrealized losses that have not been recognized as other-than-temporary impairments. The impairment loss recognition and measurement guidance was to be applicable to other-than-temporary impairment evaluations in reporting periods beginning after June 15, 2004. In September 2004, the FASB proposed additional guidance related to debt securities that are impaired because of interest rate and/or sector spread increases, and delayed the effective date of EITF 03-01. We do not expect the adoption of EITF 03-01 to have a material effect on our financial condition, results of operations, or liquidity. EITF 03-01 also includes disclosure requirements for investments in an unrealized loss position for which other-than-temporary impairments have not been recognized. These disclosures are included in the year ended December 31, 2004 as required by the EITF.

In December 2004, the FASB published SFAS 123(R), "Share-Based Payment." It requires all public companies to report share-based compensation expense at the grant date fair value of the related share-based awards. We are required to adopt the provisions of the standard effective for periods beginning after June 15, 2005. We believe that our current method of accounting for share-based payments is consistent with SFAS 123(R).

NOTE 3—LOANS AND INVESTMENTS

	December 31,		December 31, 2004		
	2004	2003	Loan Count	Wtd. Avg. Pay Rate	Wtd. Avg. Remaining Maturity
	Unpaid Principal				
Bridge loans	\$274,307,422	\$127,971,220	22	6.86%	20.2
Mezzanine loans	523,672,333	124,210,000	32	10.01%	19.7
Preferred equity investments	34,791,297	33,428,173	5	8.19%	8.5
Other	1,932,899	1,967,867	1	7.39%	224.0
	834,703,951	287,577,260	60	8.87%	19.9
Unearned revenue	(2,920,587)	(1,540,650)			
Loans and investments, net	\$831,783,364	\$286,036,610			

December 31, 2004

Bridge loans are loans to borrowers who are typically seeking short-term capital to be used in an acquisition of property and are predominantly secured by first mortgage liens on the property.

Mezzanine loans are loans that are subordinate to a conventional first mortgage loan and senior to the borrower's equity in a transaction. These loans may be in the form of a junior participating interest in the senior debt. Mezzanine financing may take the form of loans secured by pledges of ownership interests in entities that directly or indirectly control the real property or subordinated loans secured by second mortgage liens on the property.

A preferred equity investment is another form of financing in which preferred equity investments in entities that directly or indirectly own real property are formed. In cases where the terms of a first mortgage prohibit additional liens on the ownership entity, investments structured as preferred equity in the entity owning the property serve as viable financing substitutes. With preferred equity investments, the Company typically becomes a special limited partner or member in the ownership entity.

Concentration of Credit Risk

Loans and investments that can potentially subject the Company to concentrations of credit risk. The Company is subject to concentration risk in that, as of December 31, 2004, the unpaid principal balance related to 16 loans with

five unrelated borrowers represented approximately 38.1% of total assets. The Company had 61 loans and investments as of December 31, 2004. Also, no single loan or investment represented at least 10% of the Company's total assets in 2004, and revenue from any single borrower did not account for at least 10% of the Company's total revenues.

As of December 31, 2003, the unpaid principal balance related to ten loans with three unrelated borrowers represented approximately 41% of total assets. The Company had 33 loans and investments as of December 31, 2003.

In addition, as of December 31, 2003, the Company had a \$35.0 million loan which represents approximately 10% of total assets, and two loans secured by one property totaling \$45.0 million which represents approximately 13% of total assets. Summarized financial and other information related to these transactions is described in footnote 5, "Investment in equity affiliates."

Geographic Concentration Risk

As of December 31, 2004, 55%, 13%, 8% and 6% of the outstanding balance of the Company's loans and investments portfolio had underlying properties in New York, Florida, New Jersey and Maryland, respectively. As of December 31, 2003, 32%, 14%, 12%, 8% and 8% of the outstanding balance of the structured finance investments of the Company had underlying properties in New York, Maryland, Florida, Nevada and New Jersey, respectively.

NOTE 4—AVAILABLE-FOR-SALE SECURITIES

The following is a summary of the Company's available-for-sale securities at December 31, 2004.

	Face Value	Amortized Cost	Unrealized Loss	Estimated Fair Value
Federal Home Loan Mortgage Corporation, variable rate security, fixed rate of interest for three years at 3.797% and adjustable rate interest thereafter, due March 2034 (including unamortized premium of \$481,073)	\$21,340,233	\$21,821,306	\$(214,320)	\$21,606,986
Federal Home Loan Mortgage Corporation, variable rate security, fixed rate of interest for three years at 3.758% and adjustable rate interest thereafter, due March 2034 (including unamortized premium of \$208,212)	8,837,206	9,045,418	(108,793)	8,936,625
Federal National Mortgage Association, variable rate security, fixed rate of interest for three years at 3.800% and adjustable rate interest thereafter, due March 2034 (including unamortized premium of \$404,499)	15,840,969	16,245,468	(206,487)	16,038,981
	\$46,018,408	\$47,112,192	\$(529,600)	\$46,582,592

As of December 31, 2004, all available-for-sale securities were carried at their estimated fair market value based on current market quotes received from financial sources that trade such securities.

During the year ended December 31, 2004, the Company received prepayments of \$9.7 million on these securities and amortized \$394,000 of the premium paid for these securities against interest income.

These securities are pledged as collateral for borrowings under a repurchase agreement (see Note 6).

NOTE 5—INVESTMENT IN EQUITY AFFILIATES

As of December 31, 2004 and 2003, the Company had approximately \$5.3 million and \$5.9 million of investments in equity affiliates, respectively, which are described below.

In October 2004, the Company invested \$0.5 million in exchange for a 8.7% non-managing preferred interest in a joint venture that was formed to operate as a real estate business, to acquire, own, manage, develop, and sell real estate assets. The Company accounts for this investment under the equity method.

As of December 31, 2003 and 2004, the Company had two mezzanine loans totaling \$45 million outstanding to a 450 Partners Mezz III LLC, a wholly-owned subsidiary of 450 Westside Partners, LLC and the owner of 100% of the outstanding membership interests in 450 Partners Mezz II LLC who used the proceeds to acquire and renovate an office building. The loans require monthly interest payments based on one-month LIBOR and mature in January 2006. In addition, as of December 31, 2003, the Company had a \$3.0 million equity interest in an affiliate of the borrower. The Company accounts for this investment under the equity method. This interest was sold in January 2004. In August 2004, the Company invested \$1.5 million in exchange for a preferred interest in this joint venture. The Company has retained participating profits interests in several affiliates of the borrower aggregating approximately 29%.

In December 2003, the Company invested approximately \$2.1 million in exchange for a 50% non-controlling interest in Prime Outlets Member, LLC, which owns 15% of a real estate holding company that owns and operates factory outlet centers. The Company accounts for this investment under the equity method. As of December 31, 2004 and 2003, the Company had a mezzanine loan outstanding to an affiliate entity of the joint venture for \$32.4 million and \$35.0 million, respectively. In addition, the Company had a \$10.0 million senior loan participation interest outstanding to an affiliate entity of the joint venture as of December 31, 2004. The loans require monthly interest payments based on one-month LIBOR and mature in January 2006. Additionally, the Company has a 16.7% carried profits interest in the borrowing entity. The Company received \$1.2 million of distributions from this investment in 2004 as a result of the 16.7% carried profits interest which was recorded in interest income. In addition, The Company received \$0.5 million from its 50% non-controlling interest in this joint venture, which was recorded as income from equity affiliates.

In June 2003, ACM invested approximately \$818,000 in exchange for a 12.5% preferred interest in a joint venture, which owns and operates two commercial properties. The Company purchased this investment from ACM in August 2003. The Company contributed an additional \$297,000 to the investment in 2004. The Company accounts for this

investment under the equity method. In addition, as of December 31, 2004, the Company had a \$4.7 million bridge loan and a \$3.5 million mezzanine loan outstanding to affiliated entities of the joint venture. As of December 31, 2003, these loans had outstanding balances of \$4.8 million and \$3.5 million, respectively. The loans require monthly interest payments based on one month LIBOR and mature in November 2006 and June 2006, respectively.

The condensed combined balance sheets for the unconsolidated investments in equity affiliates at December 31, 2004 and 2003, are as follows (amounts in thousands):

	December 31,	
	2004	2003
Condensed Combined Balance Sheets		
Assets:		
Cash and cash equivalents	\$ 56,615	\$ 2,650
Real estate assets	944,565	587,324
Other assets	86,087	72,546
Total assets	\$1,087,267	\$662,520
Liabilities:		
Notes payable	\$ 941,718	\$531,387
Other liabilities	24,935	6,638
Total liabilities	966,653	538,025
Equity	120,614	124,495
Total liabilities and equity	\$1,087,267	\$662,520

The condensed combined statements of operations for the unconsolidated investments in equity affiliates for the years ended December 31, 2004 and 2003, are as follows (amounts in thousands):

	2004	2003
Condensed Combined Statements of Operations		
Revenue:		
Rental income	\$102,751	\$ 69,067
Reimbursement income	44,031	31,668
Other income	20,538	9,065
Total revenues	167,320	109,800
Expenses:		
Operating expenses	60,181	38,473
Interest expense	51,225	23,233
Depreciation and amortization	24,594	18,725
Other expenses	17,506	8,156
Total expenses	153,506	88,587
Net income	\$ 13,814	\$ 21,213

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

December 31, 2004

NOTE 6—NOTES PAYABLE AND REPURCHASE AGREEMENTS

The Company utilizes warehouse lines of credit, repurchase agreements, unsecured credit facilities, and loan participations to finance its loans and investments. Borrowings underlying these arrangements are primarily secured by a significant amount of the Company's loans and investments.

The following table outlines our borrowings under the Company's repurchase agreements as of December 31, 2004 and 2003:

	December 31, 2004		December 31, 2003	
	Debt Carrying Value	Collateral Carrying Value	Debt Carrying Value	Collateral Carrying Value
Repurchase agreement, financial institution, \$100 million committed line, expiration June 2005, interest is variable based on one-month LIBOR; the weighted average note rate was 5.43% and 3.41%, respectively	\$ 19,531,197	\$ 28,430,000	\$ 63,722,845	\$ 81,424,053
Repurchase agreement, Wachovia Bank National Association, \$430 million committed line, expiration December 2006, interest is variable based on one-month LIBOR; the weighted average note rate was 4.63% and 3.71%, respectively	324,388,739	493,071,885	50,175,000	80,000,000
Repurchase agreement, financial institution, \$100 million committed line, expiration July 2005, interest is variable based on one-month LIBOR; the weighted average note rate was 2.36% as of December 31, 2004	44,189,436	46,582,592	—	—
Repurchase agreement, financial institution, \$21 million committed line, expiration April 2005, interest is variable based on one-month LIBOR; the weighted average note rate was 3.79% as of December 31, 2004	21,000,000	30,000,000	—	—
Repurchase agreement, financial institution, \$50 million committed line, expiration November 2005, interest rate variable based on one-month LIBOR	—	—	—	—
Total repurchase agreements	\$409,109,372	\$598,084,477	\$113,897,845	\$161,424,053

The following table outlines our borrowings under the Company's notes payable as of December 31, 2004 and 2003:

	December 31, 2004		December 31, 2003	
	Debt Carrying Value	Collateral Carrying Value	Debt Carrying Value	Collateral Carrying Value
Structured transaction facility, financial institution, \$250 million committed line, expiration June 2006, interest rate variable based on one-month LIBOR; the weighted average note rate was 4.87% and 3.54%, respectively	\$137,199,447	\$185,254,895	\$ 58,630,626	\$ 74,603,822
Unsecured credit facility, financial institution, \$50 million committed line, expiration December 2005, interest is variable based on one-month LIBOR; the weighted average note rate was 9.37%	15,000,000	—	—	—
Junior loan participation, maturity March 2006, secured by Company's interest in a second mortgage loan with a principal balance of \$25 million, participation interest is based on a portion of the interest received from the loan, the loan's interest is variable based on one-month LIBOR	4,419,500	4,419,500	—	—
Junior loan participation, maturity September 2006, secured by Company's interest in a second mortgage loan with a principal balance of \$35 million, participation interest is based on a portion of the interest received from the loan, the loan's interest is variable based on one-month LIBOR	6,152,500	6,152,500	—	—
Senior loan participation, maturity August 2005, secured by Company's interest in a first mortgage loan with a principal balance of \$25 million, participation interest is based on 50% of the net spread of the loan, the loan is variable based on one-month LIBOR	3,000,000	3,000,000	—	—
Total notes payable	\$165,771,447	\$198,826,895	\$ 58,630,626	\$ 74,603,822

The \$100 million repurchase agreement with an expiration date of July 2005 was entered into for the purpose of financing our securities available-for-sale. The current borrowings equate to 96% of the estimated fair value of the securities (net of principal payment receivables of \$468,000) and bear interest at a rate of one-month LIBOR plus .15%. This agreement has a term of one year and will expire in July 2005.

The \$250 million structured transaction facility contains profit-sharing arrangements between the Company and the lender, which provide for profit-sharing percentages ranging from 17.5% to 45.0% of net interest income of the loans and investments financed. This cost is included in interest expense. On March 28, 2005 we terminated this facility (see Note 16).

The warehouse credit agreement, the master repurchase agreements and the secured term credit facility require that the Company pay down borrowings under these facilities pro-rata as principal payments on our loans and investments are received.

Each of the credit facilities contains various financial covenants and restrictions, including minimum net worth and debt-to-equity ratios. The Company is in compliance with all financial covenants and restrictions for the periods presented.

NOTE 7—MINORITY INTEREST

On July 1, 2003, ACM contributed \$213.1 million of structured finance assets and \$169.2 million of borrowings supported by \$43.9 million of equity in exchange for a commensurate equity ownership in ARLP, the Company's operating partnership. This transaction was accounted for as minority interest and entitled ACM to a 28% interest in ARLP as of December 31, 2003.

On April 13, 2004, the Company sold 6,750,000 shares of its common stock in an initial public offering and a concurrent offering to one of the Company's directors. On May 6, 2004, the underwriters of the initial public offering exercised a portion of their over-allotment option, which resulted in the issuance of 524,200 additional shares on May 11, 2004. On October 12, 2004, ACM exercised warrants for 629,345 operating partnership units which increased ACM's limited partnership interest to 19%. Additionally, the Company issued 973,354 shares of common stock from the exercise of warrants under the Warrant Agreement for the year ended December 31, 2004. These transactions resulted in a 9% decrease in ACM's interest in ARLP. As of December 31, 2004, minority interest was adjusted by \$5.2 million to properly reflect ACM's 19% limited partnership interest in ARLP.

NOTE 8—COMMITMENTS AND CONTINGENCIES

As of December 31, 2004, we had the following material contractual obligations (payments in thousands):

Contractual Obligations	Payments due by period ⁽¹⁾				
	2005	2006–2007	2008–2009	Thereafter	Total
Structured transaction facility ⁽⁴⁾	\$ 54,265	\$ 46,962	\$ —	\$ 35,972	\$137,199
Repurchase agreements ⁽⁴⁾	103,346	58,036	16,775	230,953	409,110
Unsecured credit facility ⁽⁴⁾	15,000	—	—	—	15,000
Loan participations ⁽⁴⁾	3,000	10,572	—	—	13,572
Outstanding unfunded commitments ⁽²⁾	4,653	30,067	1,417	—	36,137
Management fee ⁽³⁾	N/A	N/A	N/A	N/A	N/A
Totals	\$180,264	\$145,637	\$18,192	\$266,925 ⁽⁵⁾	\$611,018

(1) Represents amounts due based on contractual maturities.

(2) In accordance with certain of our loans and investments, we have outstanding unfunded commitments of \$36.1 million as of December 31, 2004, that we are obligated to fund as the borrowers meet certain requirements. Specific requirements include but are not limited to property renovations, building construction, and building conversions based on criteria met by the borrower in accordance with the loan agreements.

(3) This contract does not have fixed and determinable payments; refer to section entitled "Management Agreement" below.

(4) We have contractual obligations to make future payments in connection with short-term and long-term debt described in the section entitled "Liquidity and Capital Resources."

(5) In connection with the CDO transaction in January 2005, \$36 million of the structured transaction facility scheduled to mature in 2006, \$28 million of the repurchase agreement scheduled to mature in 2005 and \$203 million of the repurchase agreements scheduled to mature in 2006 were repaid. The CDO has a four-year replenishment period.

Litigation

The Company currently is neither subject to any material litigation nor, to management's knowledge, is any material litigation currently threatened against the company.

December 31, 2004

NOTE 9—STOCKHOLDERS' EQUITY*Common Stock*

The Company's charter provides for the issuance of up to 500 million shares of common stock, par value \$0.01 per share, and 100 million shares of preferred stock, par value \$0.01 per share.

The Company was incorporated in June 2003 and was initially capitalized through the sale of 67 shares of common stock for \$1,005.

On July 1, 2003 the Company completed a private placement for the sale of 1,610,000 units (including an over-allotment option), each consisting of five shares of the Company's common stock and one warrant to purchase one share of common stock, at \$75.00 per unit, for proceeds of approximately \$110.1 million, net of expenses. 8,050,000 shares of common stock were sold in the offering. In addition, the Company issued 149,500 shares of stock under the stock incentive plan as described below under "Deferred Compensation."

On April 13, 2004, the Company sold 6,750,000 shares of its common stock in a public offering at a price to the public of \$20.00 per share, for net proceeds of approximately \$125.4 million after deducting the underwriting discount and the other estimated offering expenses. The Company used the proceeds to pay down indebtedness. After giving effect to this offering, the Company had 14,949,567 shares of common stock outstanding. In addition, on May 6, 2004, the underwriters exercised a portion of their over-allotment option, which resulted in the issuance of 524,200 additional shares on May 11, 2004. The Company received net proceeds of approximately \$9.8 million after deducting the underwriting discount. In 2004, 2,401 shares of unvested restricted stock were forfeited. In addition, on November 2, 2004, ACM, the manager of our company, elected to be paid its third quarter incentive management in shares of common stock totaling 22,498. Moreover, for the year ended December 31, 2004, the Company issued 973,354 shares of common stock from the exercise of warrants under the Warrant Agreement and received net proceeds of \$12.9 million. After giving effect to these transactions, the Company had 16,467,218 shares issued and outstanding.

Deferred Compensation

The Company has a stock incentive plan, under which the board of directors has the authority to issue shares of stock to certain directors, officers and employees of the Company and ACM. Under the stock incentive plan, 185,000 shares of common stock were reserved for issuance pursuant to restricted stock awards. 147,500 restricted stock awards were made upon consummation of the private placement of units on July 1, 2003 and 2,000 restricted stock awards were made subsequently to certain directors. As of December 31, 2003

and 2004, 149,500 shares of restricted stock were awarded and were outstanding. Of the shares awarded, two-thirds vested immediately and the remaining one-third will vest ratably over three years on the anniversary date of the initial award. Dividends were paid on the restricted shares as dividends were paid on shares of the Company's common stock whether or not they are vested. For accounting purposes, the Company measures the compensation costs for these shares as of the date of the grant, with subsequent remeasurement for any unvested shares granted to non-employees of the Company with such amounts expensed against earnings, at the grant date (for the portion that vest immediately) or ratably over the respective vesting periods. The Company accounts for the stock incentive plan to employees of the Company and employees of ACM under the fair value method. Fair value at the grant date was \$15.00 per share, which was based on the selling price of the common stock offered in our private equity offering. For the period from June 24, 2003 (inception) to December 31, 2003 and the year ended December 31, 2004, compensation expense related to this plan totaled \$1.7 million and \$0.3 million, respectively. Such amounts appear on the Company's Consolidated Income Statement under "stock-based compensation expense." In February 2005, 1,000 restricted shares were issued to each of four independent members of the board of directors under the stock incentive plan. One-third of the restricted stock granted to each of these directors were vested as of the date of grant, another one-third will vest on January 31, 2006 and the remaining one-third will vest on January 31, 2007.

Warrants

In connection with the private placement of units by the Company on July 1, 2003, the Company issued warrants to acquire 1,610,000 shares of common stock, as adjusted for dilution, at \$15.00 per share. Concurrently, ACM was issued warrants to purchase 629,345 operating partnership units at \$15.00 per share. In July 2004, these warrants became eligible for exercise through a cash payment or by surrendering additional warrants or shares of common stock in a "cashless" transaction. These warrants expire on July 1, 2005.

For the year ended December 31, 2004, 1,321,975 common stock warrants were exercised for a total amount of \$12.9 million and 973,354 common shares were issued. Of these totals, 115,176 common shares were issued from 463,797 warrants from a "cashless" exercise. As of December 31, 2004, there were 288,025 common stock warrants outstanding. On October 12, 2004, ACM exercised all of its warrants for a total of 629,345 operating partnership units of ARLP and proceeds of \$9.4 million. Subsequent to December 31, 2004 and as of February 24, 2005, 38,558 common stock warrants were exercised, each for one share of equivalent common stock.

Preferred Stock

Concurrent with the formation of the Company, ACM contributed a portfolio of structured finance investments and related debt to ARLP, the operating partnership of the Company, in exchange for 3,146,724 units of limited partnership interest in ARLP and warrants to purchase an additional 629,345 operating partnership units. Concurrently, the Company, ARLP and ACM entered into a pairing agreement. Pursuant to the pairing agreement, each operating partnership unit issued to ACM and issuable to ACM upon exercise of its warrants for additional operating partnership units in connection with the contribution of initial assets was paired with one share of the Company's special voting preferred stock. The preferred stock was issued to ACM by the Company in exchange for a capital contribution in the amount of \$31,467. Each share of special voting preferred stock entitles the holder to one vote on all matters submitted to a vote of the Company's stockholders. A holder of special voting preferred stock will not be entitled to any regular or special dividend payments or other distributions, other than a \$0.01 per share liquidation preference. The Company has classified and designated 5,000,000 shares of its 100,000,000 authorized shares of preferred stock as special voting preferred stock. In 2004, ACM exercised 629,345 warrants in exchange for operating partnership units resulting in the issuance of 629,345 shares of preferred stock.

NOTE 10—EARNINGS PER SHARE

Earnings per share is computed in accordance with SFAS No. 128, "Earnings Per Share." Basic earnings per share ("EPS") is calculated by dividing net income by the weighted average number of shares of common stock outstanding during each period inclusive of unvested restricted stock which participate fully in dividends. Diluted EPS is calculated by dividing income before minority interest by the weighted average number of shares of common stock outstanding plus the additional dilutive effect of common stock equivalents during each period. The Company's common stock equivalents are its operating partnership units, warrants to purchase additional shares of common stock and warrants to purchase additional operating partnership units. The dilutive effect of the warrants is calculated using the treasury stock method.

As of December 31, 2003, the exercise price of the warrants approximated the market value of the common stock; therefore, they were not considered to be dilutive for purposes of calculating diluted EPS.

In 2004, ACM, the manager of our Company, earned incentive management fees totaling \$1.6 million. Based on the terms of the management agreement, ACM elected to be paid its incentive management fee in common shares totaling 66,141, of which 43,643 were issued in 2005. These 43,643 shares were anti-dilutive and have been excluded from the calculation of diluted EPS.

The following is a reconciliation of the numerator and denominator of the basic and diluted net EPS computations for the year ended December 31, 2004 and for the period June 24, 2003 (inception) to December 31, 2003.

	For the Year Ended December 31, 2004		For the Period Ended December 31, 2003	
	Basic	Diluted	Basic	Diluted
Net income	\$25,072,682	\$25,072,682	\$3,407,919	\$ 3,407,919
Add: Income allocated to minority interest		5,875,816		1,308,167
Earnings per EPS calculation	\$25,072,682	\$30,948,498	\$3,407,919	\$ 4,716,086
Weighted average number of common shares outstanding	13,814,199	13,814,199	8,199,567	8,199,567
Weighted average number of operating partnership units		3,286,387		3,146,724
Dilutive effect of warrants		265,429		
Total weighted average common shares outstanding	13,814,199	17,366,015	8,199,567	11,346,291
Earnings per common share	\$ 1.81	\$ 1.78	\$ 0.42	\$ 0.42

NOTE 11—RELATED PARTY TRANSACTIONS

Related Party Loans:

	December 31, 2004	December 31, 2003
Bridge loans	\$7,749,538	\$30,809,391
Mezzanine loans	—	5,131,490
Related party loans, net	\$7,749,538	\$35,940,881

The Company had a \$7.75 million first mortgage loan as of December 31, 2004 and 2003, had a \$13.75 million first mortgage loan and \$1.2 million second mortgage loan, which bore interest at a variable rate of one-month LIBOR plus 4.25% and matures in March 2005, outstanding to a not-for-profit corporation that holds and manages investment property from the endowment of a private academic institution.

December 31, 2004

Two of the Company's directors are members of the board of trustees of the borrower and that institution. Interest income recorded from these loans for the year ended December 31, 2004 and 2003 was approximately \$860,000 and \$402,000, respectively.

ACM has a 50% non-controlling interest in a joint venture, which was formed to acquire, develop and/or sell real estate assets. At December 31, 2004 and 2003, ACM's investment in this joint venture was approximately \$2.6 million. All loans outstanding to this joint venture were repaid in full in 2004. At December 31, 2003, we had a \$16.0 million bridge loan outstanding to the joint venture, which was collateralized by a first lien position on a commercial real estate property. This loan was funded by ACM in June 2003 and was purchased by us in July 2003. The loan required monthly interest payments based on one-month LIBOR and was repaid in full in 2004. We had agreed to provide the borrower with additional mezzanine financing in the amount of up to \$8.0 million. The mezzanine financing required interest payments based on one-month LIBOR and was repaid in full in 2004. Interest income recorded from these loans for the period ended December 31, 2004 and 2003 was approximately \$848,000 and \$486,000, respectively.

The Company's \$16.0 million bridge loan to the joint venture was contributed by ACM as one of the structured finance assets contributed to the Company on July 1, 2003 at book value, which approximates fair value. At the time of contribution, ACM also agreed to provide a limited guarantee of the loan's principal amount based any profits realized on its retained 50% interest in the joint venture with the borrower and ACM's participating interests in borrowers under three other contributed structured finance assets.

At the time of ACM's origination of three of the structured finance assets that it contributed to us on July 1, 2003 at book value, which approximates fair value, each of the property owners related to these contributed assets granted ACM participating interests that share in a percentage of the cash flows of the underlying properties. Upon contribution of the structured finance assets, ACM retained these participating interests and its 50% non-controlling interest in the joint venture to which it had made the \$16.0 million bridge loan. ACM agreed that if any portion of the outstanding amount of any of these four contributed assets is not paid at its maturity or repurchase date, ACM will pay to us, subject to the limitation described below, the portion of the unpaid amount of the contributed asset up to the total amount then received by ACM due to the realization of any profits on its retained interests associated with any other of the four contributed assets (which had an aggregate balance of \$48.3 million as of December 31, 2003). However, ACM will no

longer be obligated to make such payments to us when the remaining accumulated principal amount of the four contributed assets, collectively, falls below \$5 million and none of the four contributed assets were in default. In 2004, two of these investments matured and the borrowers paid the amount due in full. The remaining two investments have an aggregate balance of \$22.3 million as of December 31, 2004.

In addition, as of December 31, 2004, approximately \$0.3 million of interest payments from borrowers due from ACM were included in other assets. These payments were remitted in January 2005. As of December 31, 2004, approximately \$0.6 million of interest reserve payments due to ACM were included in other liabilities. These payments were remitted in January 2005.

In 2003, ACM received a brokerage fee for services rendered in arranging a loan facility for a borrower. A portion of the loan facility was provided by the Company. The Company was credited \$146,918 of this brokerage fee which represented the Company's proportionate share of the loan facility provided to the borrower and is included in other assets at December 31, 2003, which was received in January 2004.

NOTE 12—DISTRIBUTIONS

In order to qualify as a REIT, the Company must currently distribute at least 90% of its taxable income and must distribute 100% of its taxable income in order not to be subject to corporate federal income taxes on retained income. The Company anticipates it will distribute all of its taxable income to its stockholders. Because taxable income differs from cash flow from operations due to non-cash revenues or expenses (such as depreciation), in certain circumstances, the Company may generate operating cash flow in excess of its distributions or, alternatively, may be required to borrow to make sufficient distribution payments.

During the year ended December 31, 2004, the Company declared and paid distributions totaling \$15.6 million, or \$1.16 per share. For the period of June 24, 2003 (inception) to December 31, 2003, the Company declared and paid distributions totaling \$4.1 million, or \$0.50 per share. For tax purposes, 100% of dividends declared in 2004 are classified as ordinary income.

On January 13, 2005, the Company declared distributions of \$0.47 per share of common stock, payable with respect to the three months ended December 31, 2004 to stockholders of record at the close of business on January 31, 2005. These distributions were subsequently paid on February 15, 2005. Subsequent to December 31, 2004 and through the date of record, 38,558 common stock warrants were exercised, each for one share of equivalent common stock.

NOTE 13—MANAGEMENT AGREEMENT

The Company and ARLP have entered into a management agreement with ACM which has an initial term of two years with automatic one-year extensions, subject to certain termination rights. After the initial two-year term, the Company will be able to terminate the management agreement without cause for any reason upon six months' prior written notice to ACM. If the Company terminates the management agreement without cause, or gives ACM notice of non-renewal, in order to manage its operations internally, the Company will be required to pay ACM a termination fee equal to the base management fee and the incentive compensation earned by ACM during the 12-month period preceding the termination. If, without cause, the Company terminates the management agreement or elects not to renew it for any other reason, the Company will be required to pay ACM a termination fee equal to two times the base management fee and the incentive compensation earned by ACM during the 12-month period preceding the termination.

The Company's chief executive officer is also ACM's chief executive officer and controlling equity owner. ACM has agreed to provide the Company with structured finance investment opportunities and loan servicing as well as other services necessary to operate its business. The Company's chief executive officer, chief financial officer and general counsel and secretary are not employees of the Company. The Company relies to a significant extent on the facilities and resources of ACM to conduct its operations. The management agreement requires ACM to manage the business affairs in conformity with the policies and the general investment guidelines that are approved and monitored by the Company's board of directors. ACM's management of the Company is under the direction or supervision of the Company's board of directors.

For performing services under the management agreement, the Company pays ACM an annual base management fee payable monthly in cash as a percentage of ARLP's equity and equal to 0.75% per annum of the equity up to \$400 million, 0.625% per annum of the equity from \$400 million to \$800 million and 0.50% per annum of the equity in excess of \$800 million. For purposes of calculating the base management fee, equity equals the month end value computed in accordance with GAAP of (1) total partners' equity in ARLP, plus or minus (2) any unrealized gains, losses or other items that do not affect realized net income.

The Company also pays ACM incentive compensation each fiscal quarter, calculated as (1) 25% of the amount by which (a) ARLP's funds from operations per unit of partnership interest in ARLP, adjusted for certain gains and losses, exceeds (b) the product of (x) 9.5% per annum or the Ten Year U.S. Treasury Rate plus 3.5%, whichever is greater, and (y) the weighted average of book value of the net assets contributed by ACM to ARLP per ARLP partnership unit, the offering price per share of the Company's common equity in the private offering on July 1, 2003 and subsequent offerings and the issue price per ARLP partnership unit for subsequent contributions to ARLP, multiplied by (2) the weighted average of ARLP's outstanding partnership units. At least 25% of this incentive compensation is paid to ACM in shares of the Company's common stock, subject to ownership limitations in the Company's charter. With respect to all loans and investments originated during the term of the management agreement, the Company has also agreed with ACM that the Company pays ACM an amount equal to 100% of the origination fees paid by the borrower up to 1% of the loan's principal amount.

The incentive compensation is measured annually in arrears; provided, however, ACM shall receive quarterly installments thereof in advance. The quarterly installments are calculated based on the results for the period of twelve months ending on the last day of the fiscal quarter with respect to which such installment is payable. Each quarterly installment payment is deemed to be an advance of a portion of the incentive fee payable for the year. At least 25% of this incentive compensation fee is paid to ACM in shares of the Company's common stock. For purposes of determining the number of shares that are paid to ACM to satisfy the common stock portion of the incentive management fee from and after the date the Company's common shares are publicly traded, each common share shall have a value equal to the average closing price per common share based on the last twenty days of the fiscal quarter with respect to which the incentive fee is being paid. The incentive compensation fee is accrued as it is earned. In accordance with Issue 4(b) of EITF 96-18, "Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services," the expense incurred for incentive fee paid in common stock is determined using the amount of stock calculated as noted above and the quoted market price of the stock on the last day of each quarter. At

December 31, 2004

December 31, the Company remeasures the incentive fee expense paid to ACM in shares of the Company's common stock in accordance with the guidance provided by Issue 4(a) of EITF 96-18, which discusses how to measure at the measurement date when certain terms are not known prior to the measurement date. Accordingly, expense recorded related to common stock issued as a portion of incentive fee was adjusted to reflect the fair value of the stock on the measurement date when the final calculation of total incentive fee was determined. In the event the calculated incentive compensation for the full year is an amount less than the total of the installment payments made to ACM for the year, ACM will refund to the Company the amount of such overpayment in cash regardless of whether such installments were paid in cash or common stock. In such case, the Company would record a negative incentive fee expense in the quarter when such overpayment is determined. In 2004, the full-year incentive fee was greater than the sum of the quarterly installments.

ACM is responsible for all costs incident to the performance of its duties under the management agreement, including compensation of its employees, rent for facilities and other "overhead" expenses. The Company is required to pay or reimburse ACM for all expenses incurred on behalf of the Company in connection with the raising of capital or the incurrence of debt, interest expenses, taxes and license fees, litigation and extraordinary or non-recurring expenses.

Under the terms of the management agreement, ACM is also required to provide the Company with a right of first refusal with respect to all structured finance transactions identified by ACM or its affiliates. The Company has agreed not to pursue, and to allow ACM to pursue, any real estate opportunities other than structured finance transactions. In addition, ACM's

chief executive officer, Ivan Kaufman, has entered into a non-competition agreement with the Company pursuant to which he has agreed not to pursue structured finance investment opportunities, except as approved by the board of directors of the Company.

For the year ended December 31, 2004, ACM earned incentive compensation installments totaling \$1,623,000, of which \$499,000 was elected by ACM to be paid in 22,498 shares of common stock in November 2004. As of December 31, 2004, ACM's fourth quarter installment of \$1,124,000 was included in other liabilities. As provided for in the management agreement, ACM elected to receive this entire incentive compensation fee in common stock. This fee was paid in February 2005 in common shares totaling 43,643. No incentive compensation was earned or paid in the period June 24, 2003 (inception) to December 31, 2003.

For the year ended December 31, 2004, ACM earned \$1,992,000 in base management fees, of which approximately \$188,000 of fees were due to ACM for the month ended December 31, 2004. They were included in other liabilities and paid subsequently in January 2005. In the period June 24, 2003 (inception) to December 31, 2003, ACM earned \$588,000 in base management fees.

NOTE 14—DUE TO BORROWERS

Due to borrowers represents borrowers' funds held by the Company to fund certain expenditures or to be released at the Company's discretion upon the occurrence of certain pre-specified events, and to serve as additional collateral for borrowers' loans. While retained, these balances earn interest on behalf of the borrower in accordance with the specific loan terms they are associated with.

NOTE 15—FAIR VALUE OF FINANCIAL INSTRUMENTS

SFAS No. 107, "Disclosures about Fair Value of Financial Instruments," requires disclosure of the estimated fair value of an entity's assets and liabilities considered to be financial instruments. The following table summarizes the carrying values and the estimated fair values of financial instruments as of December 31, 2004 and 2003. Fair value estimates are dependent upon subjective assumptions and involve significant uncertainties resulting in variability in estimates with changes in assumptions.

	December 31, 2004		December 31, 2003	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Financial assets:				
Loans and investments, net	\$831,783,364	\$831,783,364	\$286,036,610	\$286,036,610
Related party loans, net	7,749,538	7,749,538	35,940,881	35,940,881
Available-for-sale securities	46,582,593	46,582,593	—	—
Financial liabilities:				
Notes payable and repurchase agreements	574,880,819	574,880,819	172,528,471	172,528,471

The following methods and assumptions were used by the Company in estimating the fair value of each class of financial instrument:

Loans and Investments, Net: Fair values of variable-rate loans and investments with no significant change in credit risk are based on carrying values. Fair values of other loans and investments are estimated using discounted cash flow methodology, using discount rates, which, in the opinion of management, best reflect current market interest rates that would be offered for loans with similar characteristics and credit quality.

Related Party Loans, Net: Fair values of variable-rate loans and investments with no significant change in credit risk are based on carrying values. Fair values of other loans and investments are estimated using discounted cash flow methodology, using discount rates, which, in the opinion of management, best reflect current market interest rates that would be offered for loans with similar characteristics and credit quality.

Notes Payable and Repurchase Agreements: Fair values approximate the carrying values reported in the balance sheets.

Available-for-Sale Securities: Fair values are approximated on current market quotes received from financial sources that trade such securities.

NOTE 16—SUBSEQUENT EVENTS

On January 19, 2005 the Company completed a non-recourse collateralized debt obligation (“CDO”) transaction, whereby a portfolio of real estate related assets was contributed to a consolidated subsidiary which issued \$305 million of investment grade-rated floating-rate notes in a private placement. The subsidiary retained the equity interest in the issuer with a value of approximately \$164 million. The notes are secured by a portfolio of real estate-related assets with a face value of approximately \$441 million, consisting primarily of bridge loans, mezzanine loans and junior participating interests in first mortgages, and by approximately \$28 million of cash available for acquisitions of loans and other permitted investments. The notes have an initial weighted

average spread of approximately 77 basis points over three-month LIBOR. The facility has a four-year replenishment period that allows the principal proceeds from repayments of the collateral assets to be reinvested in qualifying replacement assets, subject to certain conditions. The Company intends to own the portfolio of real estate-related assets until its maturity and will account for this transaction on its balance sheet as a financing. In connection with the CDO, the Company entered into two interest rate swap agreements to hedge its exposure to the risk of changes in the difference between three-month LIBOR and one-month LIBOR. These interest rate swaps became necessary due to the investor’s return being paid based on a three-month LIBOR index while the assets contributed to the CDO are yielding interest based on a one-month LIBOR index. These swaps were executed on December 21, 2004 with notional amounts of \$469 million and expire in January 2012. As of December 31, 2004, the market value of these swaps was insignificant to the financial statements.

On January 31, 2005 the Company entered into a \$50 million credit facility with a shareholder who beneficially owned approximately 7.1% of our outstanding common stock as of December 31, 2004. The facility includes a \$30 million term loan, a \$10 million term loan and a \$10 million revolving facility. The facility is secured by loans and investments in the Company’s portfolio. The facility has a term of one year with two six-month renewal options and bears interest at a spread over LIBOR.

On March 15, 2005 the Company, through a newly-formed wholly-owned subsidiary of its operating partnership, issued \$27.1 million of junior subordinated notes in a private placement. These securities are unsecured, have a maturity of 29 years, pay interest quarterly at a floating rate of interest based on LIBOR and, absent the occurrence of special events, are not redeemable during the first five years.

On March 29, 2005 we terminated the Company’s \$250 million structured transaction facility scheduled to expire in June 2006. We simultaneously repaid all indebtedness outstanding on that date. This debt underlying certain of our assets were transferred to our other facilities.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

December 31, 2004

NOTE 17—SUMMARY QUARTERLY CONSOLIDATED FINANCIAL INFORMATION—UNAUDITED

The following tables represent summarized quarterly financial data of the Company which, in the opinion of management, reflects all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the Company's results of operations:

For the year ended December 31, 2004:	For the Three Months Ended			
	December 31,	September 30,	June 30,	March 31,
Revenue:				
Interest income	\$20,674,843	\$17,149,646	\$11,939,350	\$8,163,391
Other income	6,636	9,098	5,427	21,104
Total revenue	20,681,479	17,158,744	11,944,777	8,184,495
Expenses:				
Interest expense	7,539,501	5,898,637	3,310,544	2,623,893
Employee compensation and benefits	646,720	448,564	617,137	613,306
Stock-based compensation	67,544	49,792	92,806	114,201
Selling and administrative	752,793	544,575	366,843	244,311
Management fee—related party	1,721,928	1,058,845	540,939	293,118
Total expenses	10,728,486	8,000,413	4,928,269	3,888,829
Income before minority interest and income from equity affiliates	9,952,993	9,158,331	7,016,508	4,295,666
Income from equity affiliates	525,000	—	—	—
Income before minority interest	10,477,993	9,158,331	7,016,508	4,295,666
Income allocated to minority interest	1,923,558	1,524,359	1,236,560	1,191,339
Net income	\$ 8,554,435	\$ 7,633,972	\$ 5,779,948	\$3,104,327
Basic earnings per common share	\$ 0.52	\$ 0.48	\$ 0.39	\$ 0.38
Diluted earnings per common share	\$ 0.52	\$ 0.47	\$ 0.38	\$ 0.38

Net income shown agrees with the Company's quarterly report(s) on Form 10-Q as filed with the Securities and Exchange Commission. However, individual line items vary from such report(s) due to participation's interest recorded as an offset to Interest Income, during subsequent periods being retroactively reclassified to Interest Expense for the third and fourth quarter's of 2004.

For the period June 24, 2003 to December 31, 2003:	For the Three Months Ended	
	December 31,	September 30,
Revenue:		
Interest income	\$5,342,459	\$4,669,990
Other income	156,002	500
Total revenue	5,498,461	4,670,490
Expenses:		
Interest expense	947,877	721,854
Employee compensation and benefits	493,491	446,845
Stock-based compensation	133,693	1,587,674
Selling and administrative	400,393	133,304
Management fee—related party	294,233	293,501
Total expenses	2,269,687	3,183,178
Income before minority interest and income from equity affiliates	3,228,774	1,487,312
Income from equity affiliates	—	—
Income before minority interest	3,228,774	1,487,312
Income allocated to minority interest	895,610	412,557
Net income	\$2,333,164	\$1,074,755
Basic earnings per common share	\$ 0.28	\$ 0.13
Diluted earnings per common share	\$ 0.28	\$ 0.13

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

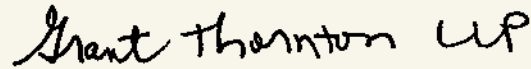
The Members of
Arbor Commercial Mortgage, LLC

We have audited the accompanying consolidated statement of revenue and direct operating expenses of the Structured Finance Business (the "SF Business" or the "Company") of Arbor Commercial Mortgage, LLC and Subsidiaries ("ACM") for the year ended December 31, 2002. This financial statement is the responsibility of ACM's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

The accompanying financial statement was prepared for the purpose of complying with the rules and regulations of the Securities and Exchange Commission for inclusion in the registration Statement on Form S-11 of Arbor Realty Trust, Inc. and do not purport to be a complete presentation of the results of operations that would have resulted if the SF Business had operated as an unaffiliated independent company.

In our opinion the financial statement referred to above present fairly, in all material respects, the revenue and direct operating expenses of the SF Business of ACM for the year ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America.



New York, New York
October 23, 2003

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Members of
Arbor Commercial Mortgage, LLC

We have audited the accompanying consolidated statement of revenue and direct operating expenses of the Structured Finance Business (the "SF Business") or (the "Company") of Arbor Commercial Mortgage, LLC and Subsidiaries ("ACM") for the six month period ended June 30, 2003. This financial statement is the responsibility of ACM's management. Our responsibility is to express an opinion on this financial statement based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provide a reasonable basis for our opinion.

The accompanying financial statement was prepared for the purpose of complying with the rules and regulations of the Securities and Exchange Commission and does not purport to be a complete presentation of the results of operations that would have resulted if the SF Business had operated as an unaffiliated independent company.

In our opinion, the financial statement referred to above presents fairly, in all material respects, the revenue and direct operating expenses of the SF Business of ACM for the six month period ended June 30, 2003, in conformity with U.S. generally accepted accounting principles.

Ernst + Young LLP

February 27, 2004
New York, New York

CONSOLIDATED STATEMENTS OF REVENUE AND DIRECT OPERATING EXPENSES

	Six Months Ended June 30, <u>2003</u>	Year Ended December 31, <u>2002</u>
Revenue:		
Interest income	\$7,688,465	\$14,532,504
Other income	1,552,414	1,090,106
Total revenue	9,240,879	15,622,610
Direct operating expenses:		
Interest expense	3,468,275	6,586,640
Employee compensation and benefits	1,751,147	2,827,191
Selling and administrative	458,266	910,924
Provision for loan losses	60,000	3,315,000
Total direct operating expenses	5,737,688	13,639,755
Revenue in excess of direct operating expenses before gain on sale of loans and real estate and income from equity affiliates	3,503,191	1,982,855
Gain on sale of loans and real estate	1,024,268	7,470,999
Income from equity affiliates	—	632,350
Revenue, gain on sale of loans and real estate and income from equity affiliates in excess of direct operating expenses	\$4,527,459	\$10,086,204

See notes to consolidated financial statements.

NOTE 1—DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION

On July 1, 2003, Arbor Commercial Mortgage, LLC (“ACM”) contributed a portfolio of structured finance investments and related debt to Arbor Realty Limited Partnership (“ARLP”), the operating partnership of Arbor Realty Trust, Inc. (“ART”). In addition, certain employees of ACM were transferred to ARLP. These assets, liabilities and employees represent a substantial portion of ACM’s structured finance business (“SF Business”) or (the “Company”). Through its SF Business, ACM invests in real estate related bridge and mezzanine loans, preferred equity and other real estate related assets.

The SF Business of Arbor Commercial Mortgage, LLC is not a legal entity and the assets and liabilities associated with the SF Business are components of a larger business. Accordingly, the information included in the accompanying consolidated financial statements has been obtained from ACM’s consolidated historical accounting records. The SF Business never operated as a separate business entity or division of ACM but rather as an integrated part of ACM’s consolidated business. Accordingly, the statements of revenue and direct operating expenses do not include charges from ACM for corporate general and administrative expense because ACM considered such items to be corporate expenses and did not allocate them to individual business units. Such expenses included costs for ACM’s executive management, corporate facilities and overhead costs, corporate accounting and treasury functions, corporate legal matters and other similar costs.

The statements of revenue and direct operating expenses include the revenue and direct operating expenses that relate to the SF Business. Direct operating expenses include interest expense applicable to the funding costs of the SF Business loans and investments, salaries and related fringe benefit costs, provision for loan losses and other expenses directly associated with revenue-generating activities. Direct operating expenses also include allocations of certain expenses, such as telephone, office equipment rental and maintenance, office supplies and marketing, which were directly associated with the SF Business and were allocated based on headcount of the SF Business in relation to the total headcount of ACM. All of these allocations are based on assumptions that management believes are reasonable under the circumstances.

A statement of cash flows is not presented because the SF Business did not maintain a separate cash balance. Other than the debt required to fund the loans and investments made by the SF Business, its operating activities were funded by ACM. Because the SF Business never operated as a separate business or division of ACM, the accompanying consolidated financial statements are not intended to be a complete presentation of the historical financial position, results of operations and cash flows of the SF Business. The historical operating results of the SF Business may not be

indicative of the future operating results of ART. The accompanying consolidated financial statements were prepared for inclusion in the Form S-11 of ART and do not purport to reflect the assets and liabilities or results of operations that would have resulted if the SF Business had operated as an unaffiliated independent company.

The consolidated financial statements include the financial statements of ACM, its wholly-owned subsidiaries, and partnerships or other joint ventures in which ACM holds, directly or indirectly, over fifty percent of the outstanding voting shares. When partnership voting interest are not clearly indicated, ACM reviews other factors to determine control, such as whether ACM is entitled to over 50% of the profits and losses of the partnership. Additionally, for investments in limited partnerships, ACM reviews the rights and obligations of the general partner and the limited partners to determine if in substance the general partner controls such entity. These rights and obligations include such items as whether the limited partner has the right to replace the general partner, approve the sale or refinancing of the partnership assets or approve the acquisition of additional significant partnership assets. In instances where ACM has a majority voting interest but minority partners have significant participation, such as the right to establish operating and capital decisions of the entity, ACM does not consolidate this entity. Based on this criteria, investments in partnerships or joint ventures that ACM does not control are accounted for under the equity method.

NOTE 2—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES*Use of Estimates*

The preparation of consolidated financial statements in conformity with accounting principals generally accepted in the United States of America requires management to make estimates and assumptions in determining the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Real Estate Owned

Real estate owned represents commercial real estate property acquired through foreclosure or deed in lieu of foreclosure that the SF Business owns and operates. Such assets are classified as held for sale and not depreciated. They are carried at the lower of cost or fair value less cost to sell. The Company reviews its real estate assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

Loans and Investments

Loans held for investment are intended to be held to maturity and, accordingly, are carried at cost, net of unamortized

loan origination costs and fees, unless such loan or investment is deemed to be impaired.

The SF Business invests in preferred equity interests that allow the SF Business to participate in a percentage of the underlying property's cash flows from operations and proceeds from a sale or refinancing. At the inception of each such investment, management must determine whether such investment should be accounted for as a loan, joint venture or as real estate. To date, management has determined that all such investments are properly accounted for and reported as loans.

Specific valuation allowances are established for impaired loans based on the fair value of collateral on an individual loan basis. The fair value of the collateral is determined by an evaluation of operating cash flow from the property during the projected holding period, and estimated sales value computed by applying an expected capitalization rate to the stabilized net operating income of the specific property, less selling costs, discounted at market discount rates. If upon completion of the valuation, the fair value of the underlying collateral securing the impaired loan is less than the net carrying value of the loan, an allowance is created with a corresponding charge to the provision for loan losses. The allowance for each loan is maintained at a level believed adequate by management to absorb probable losses.

Revenue Recognition

The revenue recognition policies of the SF Business are as follows:

Interest Income—Interest income is recognized on the accrual basis as it is earned. In most instances, the borrower pays an origination fee, an additional amount of interest at the time the loan is closed, and deferred interest upon maturity of the loan. This additional income, as well as any direct loan origination costs incurred, is deferred and recognized over the life of the related loan as a yield adjustment. Income recognition is suspended for loans when in the opinion of management a full recovery of income and principal becomes doubtful. Income recognition is resumed when the loan becomes contractually current and performance is demonstrated to be resumed. Several of the loans provide for accrual of interest at specified rates, which differ from current payment terms. Interest is recognized on such loans at the accrual rate subject to management's determination that accrued interest and outstanding principal are ultimately collectible, based on the underlying collateral and operations of the borrower. If management cannot make this determination regarding collectibility, interest income is recognized only upon actual receipt.

Other Income—Other income includes several types of income which are recorded upon receipt. Certain of the Company's loans and investments provide for additional payments based on the borrower's operating cash flow, appreciation of the underlying collateral, payments calculated

based on the timing of when the loan pays off and changes in interest rates. Such amounts are not readily determinable and are recorded as other income upon receipt.

Gain on Sale of Loans and Real Estate

For the sale of loans and real estate, recognition occurs when all the incidence of ownership passes to the buyer.

Income from Equity Affiliates

The SF Business has several joint ventures that were formed to lend to, acquire, develop and/or sell real estate assets. Such investments are recorded under the equity method. The Company records its share of the net income from the underlying properties. The gain or loss on disposition of a joint venture interest is recorded as gain on sale of loans and real estate.

Income Taxes

No provision or benefit for income taxes has been provided in the accompanying consolidated financial statements due to the fact that the SF Business was not operated as a stand-alone unit and no allocation of ACM's income tax provision/benefit has been made to the SF Business. ACM is a limited liability company (which is taxed as a partnership), and accordingly, the taxable income or loss of ACM is included in the federal and state income tax returns of ACM's individual members.

NOTE 3—SELECTED CASH FLOW INFORMATION

A statement of cash flows is not presented because the SF Business did not maintain a separate cash balance. Other than the debt required to fund the loans and investments of the SF Business, operating activities were funded by ACM. Selected cash flow from investing and financing activities is presented below.

	June 30, 2003	December 31, 2002
Cash flows from investing activities:		
Loans and investments originated	\$(117,176,849)	\$(116,810,564)
Payoffs and paydowns of loans and investments	76,106,055	105,608,865
Cash flows from financing activities:		
Proceeds from notes payable and repurchase agreements	93,228,860	86,853,319
Payoffs and paydowns of notes payable and repurchase agreements	(64,019,933)	77,426,577

NOTE 4—LOANS AND INVESTMENTS

A bridge loan was foreclosed and reclassified as real estate owned in 2002. Prior to foreclosure, the Company in 2002 recorded a provision for loan losses of \$3,075,000 to reflect this asset at its estimated fair value, excluding an estimated \$300,000 of foreclosure cost. This amount was charged-off when the loan was reclassified as real estate owned.

December 31, 2002, and for the Six Months Ended June 30, 2003

A mezzanine loan was deemed to be impaired in 2002 and a \$240,000 provision for loan losses was recorded to reflect this loan at its estimated fair value in 2002 and \$60,000 in the six months ended June 30, 2003. In accordance with the Company's policy for revenue recognition, income recognition has been suspended on this loan.

NOTE 5—BUSINESS ACQUISITIONS AND INVESTMENT IN EQUITY AFFILIATES

The Company had a 26% interest in a joint venture, which owns and operates a multi-family real estate property. In March of 2002, the Company sold its investment in the joint venture and recorded a gain of \$6.8 million. The Company received net income from this joint venture of \$588,600 prior to the sale in 2002.

The Company has several other joint ventures that were formed to acquire, develop and/or sell real estate assets which the Company does not control. The Company recorded net income from these joint ventures of \$43,750 in 2002.

NOTE 6—COMMITMENTS AND CONTINGENCIES

Litigation

In the normal course of business, the Company is subject to various legal proceedings and claims, the resolution of which, in management's opinion, will not have a material adverse effect on the financial position or the results of operations of the Company.

NOTE 7—RELATED PARTY TRANSACTIONS

The Company has a 50% non-controlling interest in a joint venture, which was formed to acquire, develop and/or sell real estate assets. At December 31, 2002, the Company's investments in this joint venture were approximately \$2.3 million. The Company accounts for this investment under the equity method. At December 31, 2002, the Company had a bridge loan outstanding to the joint venture, which is collateralized by a first lien position on a commercial real estate property. There is a limited guarantee on the loan of 50% by the chief executive officer of ACM and 50% by the key principal of the joint venture. In connection with the joint venture agreement the Company has agreed to provide the borrower with additional mezzanine financing. The loan will be funded in two equal installments. The funding will be drawn down as construction progresses. This additional financing is secured by a second mortgage lien on the property. In addition, an interest and renovation reserve is in place to cover both the bridge and mezzanine loans. Interest income recorded from these loans was approximately \$449,000 for the year ended December 31, 2002.

In June 2003, the Company invested approximately \$818,000 in exchange for a 12.50% preferred interest in a joint venture, which owns and operates two commercial properties. The Company accounts for this investment under the equity method. In June 2003, the Company funded two

mezzanine loans to this joint venture. Interest income recorded from these loans was approximately \$8,000 for the period ended June 30, 2003.

NOTE 8—SUBSEQUENT EVENTS

In June 2003, ART, a real estate investment trust was formed to invest in structured finance assets, particularly real estate related bridge and mezzanine loans, preferred equity and, in limited cases, discounted mortgage notes and other real estate related assets. On July 1, 2003, in exchange for a commensurate equity ownership in ART's operating subsidiary ARLP, ACM contributed \$213.1 million of structured finance assets and \$169.2 million of borrowings supported by \$43.9 million of equity. In addition, certain employees of ACM were transferred to ARLP. These assets, liabilities and employees represent the substantial portion of ACM's SF Business.

On July 1, 2003, ART completed a private placement of ART's units, each consisting of five shares of common stock and one warrant to purchase one share of common stock. Gross proceeds from the private financing combined with the concurrent equity contribution by ACM totaled approximately \$164 million in equity capital. ART will be externally managed and advised by ACM and will pay ACM a management fee in accordance with the management agreement. ACM will also originate, underwrite and service all structured finance assets on behalf of ARLP.

NOTE 9—UNAUDITED PRO FORMA CONSOLIDATED FINANCIAL INFORMATION

In June 2003, ACM formed ART, a newly organized real estate investment trust to operate and expand its SF Business. On July 1, 2003, ART completed a private placement of ART's units, each consisting of five shares of ART's common stock and one warrant to purchase one share of common stock. Gross proceeds from the private financing totaled \$120.2 million. In exchange for a commensurate equity ownership in ART's operating subsidiary, ARLP, ACM contributed \$213.1 million of structured finance assets and \$169.2 million of borrowings supported by \$43.9 million of equity. These assets and liabilities were contributed at book value, which approximates market value, and represent 88% of the assets and 98% of the liabilities of the SF Business as of June 30, 2003. In addition, certain employees of ACM were transferred to ARLP.

ART will be externally managed and advised by ACM and will pay ACM a management fee in accordance with the terms of the management agreement among ACM, ART and ARLP. ACM will also source originations, provide underwriting services and service all structured finance assets on behalf of ARLP. As a result, the operating expenses as presented in the historical consolidated financial statements would have been affected had ART been formed at an earlier time. Employee compensation and benefits expense would

have decreased by \$895,811 and \$1,518,890 for the six months ended June 30, 2003 and year ended December 31, 2002, respectively, because these costs would have been borne by ACM under terms of the management agreement. Similarly, selling and administrative expense would have decreased by \$65,752 and \$127,753 for the six months ended June 30, 2003 and year ended December 31, 2002, respectively.

In accordance with the terms of the management agreement, ACM will receive a management fee, composed of a base management fee and incentive compensation. The annual base management fee is payable monthly in cash as a percentage of ARLP's equity and equal to 0.75% per annum of the equity up to \$400 million, 0.625% per annum of the equity from \$400 million to \$800 million and 0.50% per annum of the equity in excess of \$800 million. For purposes of calculating the base management fee, equity equals the month end value computed in accordance with generally accepted accounting principles of (1) total partners' equity in ARLP, plus or minus (2) any unrealized gains, losses or other items that do not affect realized net income.

ART will also pay ACM incentive compensation each fiscal quarter, calculated as (1) 25% of the amount by which (a) ARLP's funds from operations per unit of partnership interest in ARLP, adjusted for certain gains and losses, exceeds (b) the product of (x) 9.5% per annum or the 10 year Treasury Rate plus 3.5%, whichever is greater, and (y) the weighted average of book value of the net assets contributed by ACM to ARLP per ARLP partnership unit, the offering price per share of ART's common equity in the private offering on July 1, 2003 and subsequent offerings and the issue price per ARLP partnership unit for subsequent contributions to ARLP, multiplied by (2) the weighted average of Arbor Realty Limited Partnership's outstanding partnership units. At least 25% of this incentive compensation is paid to ACM in shares of ART's common stock, subject to ownership limitations in ART's charter. ART has also agreed to share with ACM a portion of the origination fees that it receives on loans it originates through ACM.

The incentive compensation will be measured annually in arrears; provided, however, ACM shall receive quarterly installments thereof in advance. The quarterly installments will be calculated based on the results for the period of twelve months ending on the last day of the fiscal quarter with respect to which such installment is payable. Each quarterly installment payment will be deemed to be an advance of a portion of the incentive fee payable for the year. In the event the calculated incentive compensation for the full year is an amount less than the total of the installment payments made to ACM for the year, ACM will refund to ART the amount of such overpayment in cash. In such case, ART would record a negative incentive fee expense in the quarter when such overpayment is determined. The incentive compensation will be accrued as it is earned.

This pro forma information does not reflect the results of the private financing. However, gross proceeds from the private financing totaled \$120.2 million, which combined with ACM's equity contribution of \$43.9 million, resulted in total contributed capital of \$164.1 million. Offering expenses of \$10.1 million were paid by ART, resulting in stockholders' equity and minority interest of ART of \$154.0 million at its inception.

The pro forma consolidated financial information is limited to adjustments that are directly attributable to the private placement, expected to have a continuing impact on ART and are factually supportable. These adjustments are based on the assumption that certain compensation and benefits expenses and certain selling and administrative expenses incurred by the SF Business would not have been incurred if ART had been in operation during the periods presented. The pro forma financial results do not include what the impact would have been had the gross proceeds from the private financing been available to the Company during the entire period. Had these proceeds been available to the Company during the entire period, there would have been an impact on certain revenues and expenses, including the management fees payable pursuant to the management agreement. The management fees are calculated based on such factors as funds from operations and the equity of ARLP, each as defined in the management agreement. Such amounts represent speculative and forward-looking information that is not factually supportable.

The financial statements of the SF Business include the results of operations of the structured finance business segment of ACM and are not limited to the results of the structured finance assets that were transferred to ART. Accordingly, the results of certain investments in equity affiliates that were not transferred to ART have been included in the financial statements of the SF Business because they were included in the structured finance business segment even though the operating results from these equity affiliates have not been material to the structured finance business segment as a whole. In addition, ACM retained certain transactions in its structured finance portfolio with a net book value of approximately \$27.8 million, primarily because they were not deemed to be suitable investments for ART. Had these retained assets been excluded from the financial statements of the SF Business, additional adjustments to the expense base would have been necessary to estimate what expenses would have been had these assets not been in the portfolio. Such adjustments would have been speculative. Lastly, operating results for assets that matured before the contribution of structured finance assets to ART, but were in the portfolio of assets of the SF Business during the reporting period are also included in these statements.

MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

MARKET INFORMATION

Our common stock has been listed on the New York Stock Exchange under the symbol "ABR" since our initial public offering in April 2004. The following table sets forth for the indicated periods the high, low and last sales prices for our common stock, as reported on the New York Stock Exchange, and the dividends declared and paid with respect to such periods:

	High	Low	Last	Dividends Declared
2003 ⁽¹⁾				
June 24, 2003 to June 30, 2003	N/A	N/A	N/A	N/A
Third Quarter	N/A	N/A	N/A	\$0.25
Fourth Quarter	N/A	N/A	N/A	\$0.25
2004				
First Quarter ⁽¹⁾	N/A	N/A	N/A	\$0.38
April 1, 2004 to April 6, 2004 ⁽²⁾	N/A	N/A	N/A	\$0.02
April 7, 2004 to June 30, 2004 ⁽³⁾	\$21.00	\$18.40	\$19.95	\$0.33
Third Quarter	\$22.21	\$18.05	\$22.20	\$0.43
Fourth Quarter ⁽⁴⁾	\$24.85	\$20.25	\$24.54	\$0.47

(1) We were formed in June 2003 as a Maryland corporation and became a publicly traded company after the pricing of our public offering on April 6, 2004.

(2) Represents the portion of the second quarter of 2004 prior to our initial public offering.

(3) When combined with the \$0.02 paid for the period April 1 through April 6, represents a regular quarterly dividend of \$0.35 per share.

(4) On January 13, 2005, we declared distributions of \$0.47 per share of common stock, payable with respect to the three months ended December 31, 2004 to stockholders of record at the close of business on January 31, 2005.

We are organized and conduct our operations to qualify as a real estate investment trust, or a REIT, which requires that we distribute at least 90% of taxable income. Therefore, we intend to continue to declare quarterly distributions on our common stock. No assurance, however, can be given as to the amounts or timing of future distributions as such distributions are subject to our earnings, financial condition, capital requirements and such other factors as our board of directors deems relevant.

On March 18, 2005, the closing sale price for our common stock, as reported on the NYSE, was \$25.68. As of March 18, 2005, there were 3,336 record holders of our common stock. This figure does not reflect the beneficial ownership of shares held in nominee name.

EQUITY COMPENSATION PLAN INFORMATION

Information regarding securities authorized for issuance under our equity compensation plans which is set forth under the caption "Equity Compensation Plan Information" of the 2005 Proxy Statement is incorporated herein by reference.

RECENT ISSUANCE OF UNREGISTERED SECURITIES

During the quarter ending December 31, 2004, we issued a total of 422,204 shares of common stock upon the exercise of 430,016 warrants to purchase shares of our common stock and received a total of approximately \$6.3 million in proceeds as a result of the exercise of such warrants. These warrants were originally issued and sold as part of units, each consisting of five shares of common stock and one warrant. Pursuant to the terms of the warrant agreement, dated as of July 1, 2003, each of the warrants are exercisable from July 13, 2004 to July 1, 2005 for one share of common stock at an initial exercise price of \$15 in cash or a number of shares of common stock or warrants deemed to have a fair market value equivalent to the cash exercise price. Of the total number of shares of common stock issued upon the exercise of such warrants, 418,748 shares were issued in consideration of the payment of the cash exercise price and 3,456 shares were issued in consideration of the holder of the related warrant surrendering shares of common stock or additional warrants in lieu of the cash exercise price. Funds received from the exercise of warrants were initially used to pay down debt outstanding under our credit facilities.

The issuance and sale of the shares of common stock issued upon the exercise of these warrants was not registered under the Securities Act in reliance on the exemption from registration provided by Section 4(2) thereof. These transactions did not involve any public offering of common stock, the holders of the warrants had adequate access to information about us through our public filings with the SEC, and an appropriate legend was placed on the certificates evidencing the shares of common stock issued to the exercising holders of the warrants.

On November 3, 2004, we issued 22,498 shares of common stock to ACM as payment of the incentive compensation earned by ACM for the quarter ended September 30, 2004. The issuance of these 22,498 shares as payment for ACM's incentive compensation was not registered under the Securities Act in reliance on the exemption from registration provided by Section 4(2) thereof.

Corporate Information

BOARD OF DIRECTORS

Ivan Kaufman
Chairman of the Board of Directors
Arbor Realty Trust, Inc.

Jonathan A. Bernstein⁽¹⁾
Of Counsel
Pryor, Cashman, Sherman & Flynn

William Helmreich⁽¹⁾
Founder and President
Byron Research and Consulting

Walter K. Horn
Compliance Officer, General Counsel and Secretary
Arbor Realty Trust, Inc.

C. Michael Kojaian
Chief Operating Officer
The Kojaian Companies

Melvin F. Lazar⁽¹⁾
Founder and Former Managing Partner
Lazar Levine & Felix LLP

Joseph Martello
Chief Operating Officer
Arbor Management, LLC

CORPORATE OFFICERS

Ivan Kaufman
Chief Executive Officer and President

Frederick C. Herbst
Chief Financial Officer and Treasurer

Walter K. Horn
Compliance Officer, General Counsel and Secretary

John Kovarik
Chief Credit Officer

Fred Weber
Executive Vice President—Structured Finance

Gene Kilgore
Executive Vice President of Structured Securitization

⁽¹⁾Member of Audit Committee

SHAREHOLDER INFORMATION

CORPORATE OFFICE

333 Earle Ovington Boulevard, Suite 900
Uniondale, NY 11553
Tel: (516) 832-8002

COMMON STOCK LISTING

New York Stock Exchange
Symbol: ABR

TRANSFER AGENT

American Stock Transfer & Trust Company
59 Maiden Lane
New York, NY 10038
Tel: (212) 936-5100

LEGAL COUNSEL

Skadden, Arps, Slate, Meagher & Flom LLP
Four Times Square
New York, NY 10036-6522
Tel: (212) 735-3000

INDEPENDENT REGISTERED PUBLIC

ACCOUNTING FIRM

Ernst & Young, LLP
Five Times Square
New York, NY 10036
Tel: (212) 773-3000

INVESTOR RELATIONS CONTACT

Frederick C. Herbst
Chief Financial Officer
Arbor Realty Trust, Inc.
Tel: (516) 832-8002

Arbor Realty Trust, Inc. has filed Section 302 certifications as an exhibit to its Form 10-K, and the Chief Executive Officer has presented its annual certification to the NYSE.



333 EARLE OVINGTON BLVD., STE 900, UNIONDALE, NY 11553

Tel: (516) 832-8002

Fax: (516) 832-8045

www.arborrealtytrust.com