Rialto

HOLDINGS, LLC

Rialto Holdings, LLC and Subsidiaries

Fiscal Year 2014 First Quarter Report

Including Unaudited Consolidated Financial Statements
and
Management's Discussion and Analysis of Financial Condition and Results of Operations

RIALTO HOLDINGS, LLC AND SUBSIDIARIES

TABLE OF CONTENTS

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INDEPENDENT AUDITORS' REVIEW REPORT

To The Stockholder of
Rialto Holdings, LLC
Miami, Florida

We have reviewed the accompanying consolidated balance sheet of Rialto Holdings, LLC and Subsidiaries (the "Company") as of February 28, 2014, and the related consolidated statements of operations for the three-month periods ended February 28, 2014 and 2013, the consolidated statement of equity for the three-month period ended February 28, 2014, and the consolidated statement of cash flows for the three-month periods ended February 28, 2014 and 2013 (the "interim financial information").

Management's Responsibility for the Interim Financial Information

The Company's management is responsible for the preparation and fair presentation of the interim financial information in accordance with accounting principles generally accepted in the United States of America; this responsibility includes the design, implementation, and maintenance of internal control sufficient to provide a reasonable basis for the preparation and fair presentation of interim financial information in accordance with accounting principles generally accepted in the United States of America.

Auditors' Responsibility

Our responsibility is to conduct our reviews in accordance with auditing standards generally accepted in the United States of America applicable to reviews of interim financial information. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States of America, the objective of which is the expression of an opinion regarding the financial information. Accordingly, we do not express such an opinion.

Conclusion

Based on our reviews, we are not aware of any material modifications that should be made to the interim financial information referred to above for it to be in accordance with accounting principles generally accepted in the United States of America.

Member of
Deloitte Touche Tohmatsu Limited

Report on Consolidated Balance Sheet as of November 30, 2013

We have previously audited, in accordance with auditing standards generally accepted in the United States of America, the consolidated balance sheet of the Company as of November 30, 2013, and the related consolidated statements of operations, equity, and, and cash flows for the year then ended (not presented herein); and we expressed an unmodified audit opinion on those audited consolidated financial statements in our report dated February 12, 2014. In our opinion, the accompanying consolidated balance sheet of the Company as of November 30, 2013, is consistent, in all material respects, with the audited consolidated financial statements from which it has been derived.

Deloitte & Touche LLP

April 28, 2014

PART I. Financial Information

Item 1. Financial Statements

RIALTO HOLDINGS, LLC AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
AS OF FEBRUARY 28, 2014 AND NOVEMBER 30, 2013
(In thousands)

	February 28, 2014 (Unaudited)	November 30, 2013 (Audited)
ASSETS		
Cash	$ 169,404	$ 201,496
Restricted cash	18,489	2,593
Receivables, net	52,156	111,833
Loans held-for-sale	86,857	44,228
Loans receivable, net	265,419	278,392
Real estate owned - held-for-sale	186,234	197,851
Real estate owned - held-and-used, net	405,675	428,989
Investments in unconsolidated entities	164,759	154,573
Investments held-to-maturity	16,359	16,070
Deferred income tax asset, net	708	-
Other assets - net	55,204	43,288
Total assets	$ 1,421,264	$ 1,479,313
LIABILITIES AND EQUITY		
LIABILITIES:		
Accounts payable	$ 3,557	$ 3,729
Accrued expenses and other liabilities	47,240	43,580
Deferred income tax liability, net	-	7,815
Due to Parent	7,468	12,447
Notes payable and other debts payable	421,758	441,883
Total liabilities	480,023	509,454
COMMITMENTS AND CONTINGENT LIABILITIES (Note 14)		
PARENT'S EQUITY	541,027	539,446
NONCONTROLLING INTERESTS	400,214	430,413
Total equity	941,241	969,859
Total liabilities and equity	$ 1,421,264	$ 1,479,313

See notes to unaudited consolidated financial statements.

RIALTO HOLDINGS, LLC AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE MONTHS ENDED FEBRUARY 28, 2014 AND 2013
(In thousands) (Unaudited)

	Three Months Ended February 28, 2014	Three Months Ended February 28, 2013
REVENUE:		
Interest income	$ 18,462	$ 19,309
REO revenue:		
Hospital revenues	16,947	-
Rental income	5,864	4,542
Management fees	15,664	6,313
Gains from securitizations and other loan origination revenues	12,828	-
Total revenue	69,765	30,164
EXPENSES:		
General and administrative expense	24,354	12,574
REO expense, net:		
Hospital expense	19,308	-
Other REO expense, net	4,732	3,215
Provision for loan losses	6,716	7,090
Interest expense	6,409	1,317
Servicing expense	6,260	9,486
Securitization and loan origination expenses	2,734	-
Amortization of debt issuance costs	581	1,141
Depreciation expense	521	163
Total expenses	71,615	34,986
EQUITY IN EARNINGS FROM UNCONSOLIDATED ENTITIES	5,354	6,173
NET EARNINGS (INCLUDING NET EARNINGS (LOSS) ATTRIBUTABLE TO NONCONTROLLING INTERESTS)	3,504	1,351
LESS: NET EARNINGS (LOSS) ATTRIBUTABLE TO NONCONTROLLING INTERESTS	935	(328)
NET EARNINGS ATTRIBUTABLE TO RIALTO BEFORE PROVISION FOR INCOME TAXES	2,569	1,679
PROVISION FOR INCOME TAXES	988	667
NET EARNINGS ATTRIBUTABLE TO RIALTO	$ 1,581	$ 1,012

See notes to unaudited consolidated financial statements.

RIALTO HOLDINGS, LLC AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF EQUITY
FOR THE THREE MONTHS ENDED FEBRUARY 28, 2014 AND 2013
(In thousands) (Unaudited)

	Three Months Ended February 28, 2014	Three Months Ended February 28, 2013
PARENT'S EQUITY		
Beginning balance	$ 539,446	$ 53,163
Net earnings attributable to Rialto	1,581	1,012
Ending balance	$ 541,027	$ 54,175
NONCONTROLLING INTERESTS		
Beginning balance	$ 430,413	$ 445,286
Net earnings (loss) attributable to noncontrolling interests	935	(328)
Final bargain purchase acquisition adjustment	1,117	-
Distributions of capital to noncontrolling interests	(32,251)	-
Ending balance	$ 400,214	$ 444,958
TOTAL EQUITY	$ 941,241	$ 499,133

See notes to unaudited consolidated financial statements.

RIALTO HOLDINGS, LLC AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED FEBRUARY 28, 2014 AND 2013
(In thousands) (Unaudited)

	Three Months Ended February 28, 2014	Three Months Ended February 28, 2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net earnings attributable to Rialto	$ 1,581	$ 1,012
Adjustment to reconcile net earnings attributable to Rialto to net cash used in operating activities:		
Amortization of debt issuance costs	581	1,141
Depreciation expense	2,059	1,322
Net losses (gains) on loan foreclosure	68	(1,465)
Gains on sale of real estate owned	(9,509)	(8,671)
Equity in earnings from unconsolidated entities	(5,354)	(6,173)
Impairment on real estate owned	2,309	795
Deferred income tax benefit	(5,669)	(6,224)
Provision for loan losses	6,716	7,090
Distributions of earnings from unconsolidated entities	-	107
Noncontrolling interest earnings (loss)	935	(328)
Accretion of discount on investments held-to-maturity	(289)	(250)
Originations of loans held-for-sale	(295,508)	-
Proceeds from sale of loans held-for-sale	315,635	-
Principal payments on loans held-for-sale	89	-
Unrealized gains on loans held-for-sale	(3,475)	-
Changes in operating assets and liabilities:		
Restricted cash	1,078	-
Loans receivable, net	(4,707)	(5,267)
Other assets	(6,983)	2,984
Accounts payable	(172)	68
Due to Parent	(4,979)	-
Accrued expenses and other liabilities	(13,892)	(11,382)
Net cash used in operating activities	(19,486)	(25,241)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of operating equipment	(1,931)	(364)
Receipts of principal payments on loans receivable	6,879	18,434
Proceeds from sales of real estate owned	50,742	34,451
Acquisition of loans receivable	-	(5,250)
Improvements to real estate owned	(2,356)	(1,716)
Distributions of capital from unconsolidated entities	5,182	7,680
Investments in unconsolidated entities	(18,306)	-
Decrease in defeasance cash to retire notes payable	-	219,158
Net cash provided by investing activities	40,210	272,393

(Continued)

RIALTO HOLDINGS, LLC AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED FEBRUARY 28, 2014 AND 2013
(In thousands) (Unaudited)

	Three Months Ended February 28, 2014	Three Months Ended February 28, 2013
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayment of notes payable and other debts payable	(2,101)	(304,123)
Net repayments under warehouse repurchase facilities	(18,169)	-
Debt issuance costs	(295)	-
Distributions of capital to noncontrolling interest	(32,251)	-
Increase in due to Parent	-	15,849
Net cash used in by financing activites	(52,816)	(288,274)
NET DECREASE IN CASH	(32,092)	(41,122)
CASH — Beginning of period	201,496	105,310
CASH — End of period	$ 169,404	$ 64,188
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid for interest on notes payable and other debts payable	$ 1,433	$ 1,317
SUPPLEMENTAL DISCLOSURES OF NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Real estate owned acquired through loan foreclosure	$ 4,304	$ 15,077
Non-cash acquisition of Service Provider (see Note 7)	$ 8,317	$ -
Reductions in loans receivable from deficiency settlements	$ 230	$ 244

See notes to unaudited consolidated financial statements.

(Concluded)

1. ORGANIZATION AND DESCRIPTION OF BUSINESS

Rialto Holdings, LLC is a holding company that owns 100% of the legal entities Rialto Investments, LLC and Rialto Capital Management, LLC and conducts its activities through those entities and their subsidiaries (collectively, "Rialto" or the "Company"). Rialto is a leading commercial real estate investment, investment management, and finance company focused on raising, investing and managing third party capital, and, in addition, originating commercial mortgage loans which the Company sells to securitization vehicles. Rialto has a vertically-integrated operating platform consisting of over 400 professionals located in ten offices across the U.S. Rialto was founded in 2007 and is a wholly-owned subsidiary of Lennar Corporation ("Lennar" or the "Parent"), one of the largest homebuilders in the U.S.

Asset and Investment Management
The Company's real estate Asset and Investment Management business allows the Company to be a sponsor of and an investor in private equity vehicles that invest in and manage real estate related assets. This has included the Rialto Real Estate Fund, LP ("Fund I") that was initially formed in 2010 in which investors committed and contributed a total of $700 million of equity (including $75 million by the Company), the Rialto Real Estate Fund II, LP ("Fund II") that was formed in 2013 with investor commitments of $1.3 billion (including $100 million by the Company) and the Rialto Mezzanine Partners Fund, LP (the "Mezzanine Fund") that was formed in 2013 with a target of raising $300 million in capital (including $25 million committed by the Company) to invest in performing mezzanine commercial loans. In 2013, the Company also began managing a $200 million separate account for an insurance company. In 2014, the Rialto CMBS Fund, LP (the "CMBS Fund") was created to acquire, own and/or dispose of securities whose value and income payments are derived from and collaterized by specific pools of underlying assets, referred to as commercial mortgage-backed securities ("CMBS"). Rialto earns fees for its role as a manager of these vehicles and for providing asset management and other services to these vehicles and other third parties.

RMF
The Company started Rialto Mortgage Finance ("RMF") in 2013 as the Company began originating and securitizing five, seven and ten year fixed rate commercial first mortgage loans, generally with principal amounts between $2 million and $75 million, which are secured by income producing properties.

Direct Investments in Real Estate Related Assets
In 2010, the Company acquired indirectly 40% managing member equity interests in two limited liability companies ("LLCs"), in partnership with the Federal Deposit Insurance Corporation ("FDIC"). The FDIC retained 60% equity interests in the LLCs. The LLCs hold performing and non-performing loans formerly owned by 22 failed financial institutions and when the Company acquired its interests in the LLCs, the two portfolios consisted of approximately 5,500 distressed residential and commercial real estate loans ("FDIC Portfolios"). The FDIC retained 60% equity interests in the LLCs and provided $626.9 million of financing with 0% interest, which was non-recourse to the Company and the LLCs and has been paid off (see Note 10).

The LLCs meet the accounting definition of a variable interest entity ("VIE") and since the Company was determined to be the primary beneficiary, the Company consolidated the LLCs. At February 28, 2014, these consolidated LLCs had total combined assets and liabilities of $676.5 million and $20.7 million, respectively. At November 30, 2013, these consolidated LLCs had total combined assets and liabilities of $727.1 million and $20.2 million, respectively.

Also in 2010, the Company acquired approximately 400 distressed residential and commercial real estate loans (“Bank Portfolios”) and over 300 real estate owned (“REO”) properties from three financial institutions. The Company paid $310 million for the Bank portfolios and real estate related assets of which $124 million was financed through a 5-year senior unsecured note provided by one of the selling institutions.

In addition, in 2010, the Company purchased approximately $43 million face amount of non-investment grade CMBS for $19.4 million, representing a 55% discount from par value.

We also manage certain operating assets that are acquired through foreclosure of loans, which as of February 28, 2014, include a hospital operation (see Note 7).

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Significant accounting principles and practices used in the preparation of the consolidated financial statements are as follows:

Basis of Presentation - The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (“GAAP”). The accompanying consolidated financial statements include the accounts of the Company and all of its subsidiaries. All intercompany transactions and balances have been eliminated.

Unaudited/Interim Periods - These consolidated financial statements and accompanying notes as of February 28, 2014 and November 30, 2013, and for the three months ended February 28, 2014 and 2013, are unaudited and should be read in conjunction with the audited consolidated financial statements and accompanying notes included in the Annual Report for the year ended November 30, 2013.

Use of Estimates - The preparation of financial statements in conformity with GAAP requires the Company’s management to make estimates and assumptions that affect the reported amounts of assets and liabilities, at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Significant items subject to such estimates and assumptions include expected cash flows on distressed loans, allowances for loan losses, and the valuation of loans held-for-sale, real estate acquired in connection with foreclosures or in satisfaction of loans, and fair value derivative instruments. Actual results could differ from those estimates.

Restricted Cash - The Company has established a restricted cash account related to the RMF business line. These funds are restricted as they are upfront deposits and application fees the Company receives before originating the loans. Once the loan has been originated the Company recognizes the income and the cash is no longer restricted. Also, during January 2014, the Company acquired a loan service provider (see Note 7). Restricted cash is held in escrow by the loan service provider on behalf of customers and lenders and is disbursed in accordance with agreements between the transacting parties.

Defeasance Cash - The Company had established defeasance accounts for the benefit of the FDIC. These funds were restricted and were distributed pursuant to a priority of payments (see Note 3). As a result of the repayment of the FDIC Notes payable, the defeasance accounts were closed during 2013.

Loans Receivable - Revenue Recognition and Impairment - All of the acquired loans for which (1) there was evidence of credit quality deterioration since origination and (2) it was deemed probable that the Company would be unable to collect all contractually required principal and interest payments were accounted for under Accounting Standards Codification ("ASC") Topic 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality*, ("ASC 310-30"). For loans accounted for under ASC 310-30, management determined upon acquisition the loan's value based on due diligence on each of the loans, the underlying properties, and the borrowers. The Company determined fair value by discounting the cash flows expected to be collected, adjusted for factors that a market participant would consider when determining fair value. Factors considered in the valuation were projected cash flows for the loans, type of loan and related collateral and current discount rates.

Under ASC 310-30, loans were pooled together according to common risk characteristics. A pool is then accounted for as a single asset with a single component interest rate and an aggregate expectation of cash flows. The excess of the cash flows expected to be collected from the loans receivable at acquisition over the initial investment for those loans receivable is referred to as the accretable yield and is recognized as interest income over the expected life of the pools primarily using the effective yield method. The difference between contractually required payments at acquisition and the cash flows expected to be collected is referred to as the nonaccretable difference. This difference is neither accreted into income nor recorded on the Company's consolidated balance sheets. Changes in the expected cash flows of loans receivable from the date of acquisition will either impact the accretable yield or result in a charge to the provision for loan losses in the period in which the changes become probable. Prepayments are treated as a reduction of cash flows expected to be collected and a reduction of contractually required payments such that the nonaccretable difference is not affected. Subsequent significant decreases to the expected cash flows will generally result in a charge to the provision for loan losses, resulting in an increase to the allowance for loan losses, and a reclassification from accretable yield to nonaccretable difference. Subsequent probable and significant increases in cash flows will result in a recovery of any previously recorded allowance for loan losses, to the extent applicable, and a reclassification from nonaccretable difference to accretable yield. Amounts related to the ASC 310-30 loans are estimates and may change as the Company obtains additional information related to the respective loans and the inherent uncertainty associated with estimating the amount and timing of the expected cash flows associated with distressed residential and commercial real estate loans. The timing and amount of expected cash flows and related accretable yield can also be impacted by disposal of loans, loan payoffs or expected foreclosures, which result in removal of the loans from the pools. Since the cash flows are based on projections, they are subjective and can change due to unexpected changes in economic conditions and loan performance.

Nonaccrual Loans - *Revenue Recognition and Impairment* - For loans in which forecasted principal and interest could not be reasonably estimated at the loan acquisition date, management classified these loans as nonaccrual and accounts for these assets in accordance with ASC 310-10, *Receivables*, ("ASC 310-10"). When a loan is classified as nonaccrual, any subsequent cash receipt is accounted for using the cost recovery method. In accordance with ASC 310-10, a loan is considered impaired when based on current information and events it is probable that all amounts due according to the contractual terms of the loan agreement will not be collected. A provision for loan losses is recognized when the recorded investment in the loan is in excess of its fair value. The fair value of the loan is determined by using either the present value of expected future cash flows discounted at the loan's effective interest rate, the loans obtainable market price, or the fair value of the collateral less estimated costs to sell.

Loans Held-for-sale and Derivative Instruments – The originated commercial mortgage loans are classified as Loans held-for-sale on the consolidated balance sheet and are recorded at fair value. The Company elected the fair value option for its loans held-for-sale in accordance with ASC 825, *Financial Instruments*, ("ASC 825"), which permits entities to measure various financial instruments and certain other items at fair value on a contract-by-contract basis. Management believes that carrying loans held-for-sale at fair value improves financial reporting by mitigating volatility in reported earnings caused by measuring the fair value of the loans and the derivative instruments used to economically hedge them without having to apply complex hedge accounting provisions. Changes in fair values of the loans and the derivative instruments are reflected in gains from securitizations and other in the accompanying consolidated statements of operations. Interest income on these loans is calculated based on the interest rate of the loan and is recorded within revenue as Interest income in the accompanying consolidated statements of operations. Substantially all of the mortgage loans originated are sold within a short period of time in a securitization on a servicing released, non-recourse basis; although, the Company remains liable for certain limited industry-standard representations and warranties related to loan sales. The Company recognizes gains on the sale of loans into securitizations trusts when control of the loans has been relinquished. As of February 28, 2014 and November 30, 2013, the Company had $49.2 million and $109.3 million, respectively, in originated loans that were transferred to receivables, net in the accompanying consolidated balance sheets as they had been sold into a securitization trust but not yet closed as of their respective balance sheet dates.

In the normal course of business, the Company uses derivative financial instruments on these loans during the period from when the Company has originated the loan until the time in which the loan is sold. These derivatives, which are carried at fair value, are used for risk management purposes to reduce its exposure to fluctuations in mortgage-related interest rates as well as lessen its credit risk. The Company hedges its interest rate exposure through entering into interest rate swaps and swap futures and as of February 28, 2014, had fair values of approximately $0.5 million in a liability position. As of November 30, 2013, the Company had interest rate swap futures with fair values of approximately $31,000 in a liability position. Credit exposure is managed at a portfolio level through entering into credit default swaps consisting of both single "A", "AAA" and "BBB" rated CMBX swaps as well as CDX swaps, which as of February 28, 2014 and November 30, 2013, had a fair value of $1.6 million and $0.8 million, respectively, in contracts in an asset position and $1.1 million and $0.3 million, respectively, in a liability position. The Company does not enter into or hold derivatives for trading or speculative purposes (see Note 12). Derivative instruments in gain positions are recorded in Other assets – net in the consolidated balance sheets (see Note 9), while derivative instruments in loss positions are recorded within Accrued expenses and other liabilities in the consolidated balance sheets.

Deficiency Interest Income - Deficiency recoveries from foreclosed loans is a component of the Company's operations. Upon receipt of consideration from a deficiency settlement, the Company determines the fair value of the net assets received and records interest income. During the three months ended February 28, 2014 and 2013, the Company recorded $2.9 million and $3.7 million, respectively, in deficiency interest income.

Variable Interest Entities - In 2010, the Company acquired indirectly 40% managing member equity interests in two limited liability companies ("LLCs"), in partnership with the FDIC. The Company determined that each of the LLCs met the definition of a VIE and that the Company was the primary beneficiary. In accordance with ASC 810-10-65-2, *Consolidations*, ("ASC 810-10-65-2"), the Company identified the activities that most significantly impact the LLCs' economic performance and determined that it has the power to direct those activities. The economic performance of the LLCs is most significantly impacted by the performance of the LLCs' portfolios of assets, which consisted primarily of distressed residential and commercial mortgage loans. Thus, the activities that most significantly impact the LLCs' economic performance are the servicing and disposition of mortgage loans and real estate obtained through foreclosure of loans, restructuring of loans, or other planned activities associated with the monetizing of loans.

The FDIC does not have the unilateral power to terminate the Company's role in managing the LLCs and servicing the loan portfolio. While the FDIC has the right to prevent certain types of transactions (i.e., bulk sales, selling assets with recourse back to the selling entity, selling assets with representations and warranties and financing the sales of assets without the FDIC's approval), the FDIC does not have full voting or blocking rights over the LLCs' activities, making their voting rights protective in nature, not substantive participating voting rights. Other than as described in the preceding sentence, which are not the primary activities of the LLCs, the Company can cause the LLCs to enter into both the disposition and restructuring of loans without any involvement of the FDIC. Additionally, the FDIC has no voting rights with regard to the operation/management of the operating properties that are acquired upon foreclosure of loans (e.g. REO) and no voting rights over the business plans of the LLCs. The FDIC can make suggestions regarding the business plans, but the Company can decide not to follow the FDIC's suggestions and not to incorporate them in the business plans. Since the FDIC's voting rights are protective in nature and not substantive participating voting rights, the Company has the power to direct the activities that most significantly impact the LLCs' economic performance.

In accordance with ASC 810-10-65-2, the Company determined that it had an obligation to absorb losses of the LLCs that could potentially be significant to the LLCs or the right to receive benefits from the LLCs that could potentially be significant to the LLCs based on the following factors:

- Rialto/Lennar owns 40% of the equity of the LLCs and has the power to direct the activities of the LLCs that most significantly impact their economic performance through loan resolutions and the sale of REO.
- Rialto/Lennar has a management/servicer contract under which the Company earns a 0.5% servicing fee.
- Rialto/Lennar has guaranteed, as the servicer, its obligations under the servicing agreement up to $10 million.

The Company is aware that the FDIC, as the owner of 60% of the equity of each of the LLCs, may also have an obligation to absorb losses of the LLCs that could potentially be significant to the LLCs. However, in accordance with ASC 810-10-25-38A, only one enterprise, if any, is expected to be identified as the primary beneficiary of a VIE.

Since both criteria for consolidation in ASC 810-10-65-2 are met, the Company consolidated the LLCs.

During 2011, the Company acquired an equity interest in several joint ventures as part of a deficiency settlement. Management determined that each of the joint ventures met the definition of a VIE. In accordance with ASC 810-10-65-2, management identified the activities that most significantly impact the joint ventures' economic performance and determined whether it has the power to direct those activities in the joint ventures. The activities that most significantly impact the joint ventures' economic performance are the servicing and maintenance of an entity's underlying asset, which consists of commercial real estate. Although the Company has no obligation to provide financial support to any of its VIE's and has only its equity investment at risk, the Company has determined it has the right to direct the activities and to potentially receive significant benefits from one of the joint venture entities due to its majority ownership and equity position in the entity. Since both criteria for consolidation in ASC 810-10-65-2 are met, the Company has consolidated the joint venture in its consolidated financial statements.

Real Estate Owned - REO represents real estate which the Company has taken control or has effective control of in partial or full satisfaction of loans receivable. At the time of acquisition through foreclosure of a loan, REO is recorded at fair value less estimated costs to sell if classified as held for sale and at fair value if classified as held and used, which becomes the property's new basis. The fair values of these assets are determined in part by placing reliance on third-party appraisals of the properties and/or internally prepared analysis of recent offers or prices on comparable properties in the proximate vicinity. The third-party appraisals and internally developed analysis are significantly impacted by local market economy, market supply and demand, competitive conditions, and prices on comparable properties, adjusted for date of sale, location, property size, and other factors. Each REO is unique and is analyzed in the context of the particular market where the property is located. In order to establish the significant assumptions for a particular REO, the Company analyzes historical and current trends in the market and economy impacting the REO. Using available trend information, the Company then calculates its best estimate of fair value, which can include projected cash flows discounted at a rate that management believes a market participant would determine to be commensurate with the inherent risks associated with the assets and related estimated cash flow streams.

Changes in economic factors, consumer demand, and market conditions, among other things, could materially impact estimates used in the third-party appraisals and/or internally prepared analysis of recent offers or prices on comparable properties. Thus, estimates can differ significantly from the amounts ultimately realized by the Company from disposition of these assets. The amount by which the recorded investment in the loan is less than the REO's value (net of estimated cost to sell if held for sale), is recorded as a gain on foreclosure within REO expense in the accompanying consolidated statements of operations. The amount by which the recorded investment in the loan is greater than the REO's fair value (net of estimated cost to sell if held for sale), is initially recorded as impairment within REO expense in the accompanying consolidated statement of operations.

Subsequent to obtaining REO via foreclosure or directly from a financial institution, management periodically performs valuations using the methodologies described above such that the real estate is carried at the lower of its carrying value or current fair value, less estimated costs to sell if classified as held for sale. Held and used assets are tested for recoverability whenever changes in circumstances indicate that its carrying value may not be recoverable, and impairment losses are recorded for any amount by which the carrying value exceeds its fair value. Any subsequent impairment losses, operating expenses or income, and gains and losses on disposition of such properties are also recognized in income. REO assets classified as held and used are depreciated using a useful life of 40 years for commercial properties and 27 1/2 years for residential properties. REO assets classified as held for sale are not depreciated. Occasionally an asset will require certain improvements to yield a higher return. In accordance with ASC 970-340-25, *Real Estate*, construction costs incurred prior to acquisition or during development of the asset are capitalized.

Operating Equipment – Operating equipment is recorded at cost and is included in other assets – net in the consolidated balance sheets. The assets are depreciated over their estimated useful lives using the straight-line method. At the time operating properties and equipment are disposed of, the asset and related accumulated depreciation are removed from the accounts and any resulting gain or loss is credited or charged to earnings. The estimated useful life for equipment is two to ten years and for leasehold improvements is five years or the life of the lease, whichever is shorter.

Goodwill – Goodwill represents the excess of the purchase price paid over the fair value of the net assets acquired. Evaluating goodwill for impairment involves the determination of the fair value of our reporting unit in which we have recorded goodwill. A reporting unit is a component of a business line for which discrete financial information is available. Inherent in the determination of fair value of our reporting unit is certain estimates and judgments, including the interpretation of current economic indicators and market valuations as well as our strategic plans with regard to our operations. To the extent additional information arises or our strategies change, it is possible that our conclusion regarding goodwill impairment could change, which could have a material effect on our financial position and results of operations.

The Company recorded goodwill in connection with an acquisition during the first quarter of 2014 (see Note 7) and is recorded in Other assets – net in the accompanying consolidated balance sheets. Because the acquisition happened during the first quarter of 2014, there has been no annual review of goodwill as of February 28, 2014. The first annual review of goodwill will take place in the fourth quarter of 2014, unless indicators for impairment exist in earlier periods.

Management Fees Revenue - The Company provides services to a variety of legal entities and investment vehicles such as funds, joint ventures, co-investment partnerships, and other private equity structures to manage their respective investments. As a result, the Company earns and receives investment management fees, underwriting fees and due diligence fees. These fees are recorded over the period in which the services are performed, fees are determinable and collectability is reasonably assured. The Company receives investment management fees from investment vehicles based on 1) a percentage of committed or called capital during the commitment period and called capital after the commitment period ends, 2) a percentage of invested capital less the portion of such invested capital utilized to acquire investments that have been sold (in whole or in part) or liquidated. Fees earned for underwriting and due diligence services are based on actual costs incurred.

In certain situations, the Company may earn additional fees when the return on assets managed exceeds contractual thresholds (“Carried Interest”). Such revenue is only booked when substantially all of the contract terms are met, the contract is at or near completion and the amounts are known and collectability is reasonably assured. Since such revenue is recognized at the end of the life of the investment vehicle, after substantially all of the assets have been sold and investment gains and losses realized, the possibility of claw back provisions is limited.

Hospital Revenue - We recognize revenues from the Hospital operation acquired in 2013 in the period in which services are provided. Amounts we receive for treatment of patients covered by governmental programs, such as Medicare and Medicaid, and other third-party payers such as HMOs, PPOs and other private insurers, are generally less than our established billing rates. Revenues are recorded at estimated net amounts due from patients, third-party payers and others for healthcare services provided. Accordingly, revenues are reduced to net realizable value through an allowance for contractual discounts. For certain payers, such as Medicare, Medicaid, as well as some managed care payers with which we have contractual arrangements, the contractual allowances are calculated by computerized logging systems based on defined payment terms. For other payers, the contractual allowances are determined based on historical data by insurance plan. All contractual adjustments, regardless of type of payer or method of calculation, are reviewed and compared to actual experience.

Debt Issuance Costs - Certain issuance costs were incurred for the financing of the FDIC notes payable (“Notes”). These costs were approximately 3% of the principal balance of the Notes and any unamortized balance was written-off during 2013 as a result of the repayment of the Notes (see Note 10). Additionally, certain issuance costs were incurred for the financing of the 7.00% Senior Notes. These costs were approximately 2% of the principal balance of the 7.00% Senior Notes. The Company also secured two warehouse repurchase facility (“Facilities”) agreements and incurred $2.5 million of fees associated with the Facilities. Such costs associated with the Notes and the Facilities were deferred and are amortized to interest expense over the expected term of the underlying debt using the straight-line method, which approximates the effective-interest method. These costs are reflected as other assets – net in the accompanying consolidated balance sheets.

Income Tax - The Company records income taxes under the asset and liability method, whereby deferred tax assets and liabilities are recognized based on the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and attributable to operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply in the years in which the temporary differences are expected to be recovered or paid. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in earnings in the period when the changes are enacted. Interest related to unrecognized tax benefits is recognized as a component of provision for income taxes in the accompanying consolidated statements of operations.

A reduction of the carrying amounts of deferred tax assets by a valuation allowance is required if, based on the available evidence, it is more likely than not that such assets will not be realized. Accordingly, the need to establish valuation allowances for deferred tax assets is assessed each reporting period by the Company based on the more-likely-than-not realization threshold criterion. In the assessment for a valuation allowance, appropriate consideration is given to all positive and negative evidence related to the realization of the deferred tax assets. This assessment considers, among other matters, the nature, frequency and severity of current and cumulative losses, forecasts of future profitability, the duration of statutory carryforward periods, the Company's experience with loss carryforwards not expiring unused and tax planning alternatives.

Concentration of Risk - The Company's success depends to a certain extent on the general economic conditions of the geographic markets of the Company's acquired loans and foreclosed assets. At February 28, 2014 and November 30, 2013, assets held by the Company were primarily concentrated in the states of Georgia, Florida, Arizona, North Carolina, Nevada, and South Carolina. Adverse changes in the economic conditions of these geographical areas may have a significant impact on the Company's commercial and residential real estate loans, the ability of borrowers to repay these loans, and the value of the collateral securing these loans. The aforementioned may have a negative effect on the Company's business, financial condition, and results of operations. A significant portion of the Company's management fee revenue is derived from investment funds that the Company sponsors and manages. For the three months ended February 28, 2014 and 2013, 84% and 92%, respectively, of the Company's management fee revenue was earned from investment funds that the Company sponsored and managed.

3. DEFEASANCE CASH TO RETIRE NOTES PAYABLE

The Company had established defeasance accounts for the benefit of the FDIC. Funds were deposited into the defeasance accounts, pursuant to a priority of payments (which first required loan proceeds to be used for various fees, expenses, and working capital prior to any excess being deposited in the defeasance accounts), until the amount of the funds held in the defeasance accounts was equal to the sum of the outstanding principal balances of the Notes. No funds from any other source could be commingled in the defeasance accounts. The Company could not prepay all or any portion of the Notes without the prior written consent of the FDIC. As a result of the repayment of the Notes during the year ended November 30, 2013, the defeasance accounts were closed as of November 30, 2013. During the three months ended February 28, 2013, the LLCs retired $302.8 million of principal amount of the notes payable under the agreement with the FDIC through the defeasance account.

4. LOANS RECEIVABLE, NET, ACCRETABLE YIELD AND LOANS HELD-FOR-SALE

Loans Receivable, Net – The following table displays the loan portfolio by aggregate-level collateral-type classifications at February 28, 2014 and November 30, 2013 (in thousands):

	February 28, 2014	November 30, 2013
Land	$ 158,013	$ 166,950
Single family homes	55,274	59,647
Commercial properties	39,103	38,060
Other	13,029	13,735
Loans receivable, net	$ 265,419	$ 278,392

With regard to loans accounted for under ASC 310-30, the Company estimated the cash flows, at acquisition, it expected to collect on the FDIC Portfolios and Bank Portfolios. In accordance with ASC 310-30, the difference between the contractually required payments and the cash flows expected to be collected at acquisition is referred to as the nonaccretable difference. This difference is neither accreted into income nor recorded on the Company's consolidated balance sheets. The excess of cash flows expected to be collected over the cost of the loans acquired is referred to as the accretable yield and is recognized in interest income over the remaining life of the loans using the effective yield method.

The Company periodically evaluates its estimate of cash flows expected to be collected on its FDIC Portfolios and Bank Portfolios. These evaluations require the continued use of key assumptions and estimates, similar to those used in the initial estimate of fair value of the loans to allocate purchase price. Subsequent changes in the estimated cash flows expected to be collected may result in changes in the accretable yield and nonaccretable difference or reclassifications from nonaccretable difference to accretable yield. Increases in the cash flows expected to be collected will generally result in an increase in interest income over the remaining life of the loan or pool of loans. Decreases in expected cash flows due to further credit deterioration will generally result in an impairment charge recognized as a provision for loan losses, resulting in an increase to the allowance for loan losses.

The outstanding contractual payments and cash flows expected to be collected on the date of acquisition were $4.2 billion and $2.0 billion, respectively.

As of February 28, 2014 and November 30, 2013 the outstanding balance and carrying value of loans accounted for under ASC 310-30 was as follows (in thousands):

	February 28, 2014	November 30, 2013
Outstanding principal balance	$ 550,701	$ 586,901
Carrying value	$ 259,567	$ 270,075

Accretable Yield – The activity in the accretable yield for the FDIC Portfolios and Bank Portfolios during the three months ended February 28, 2014 and 2013 were as follows (in thousands):

	Three Months Ended February 28,	
	2014	2013
Beginning balance	$ 73,144	$ 112,899
Net additions	1,352	18,949
Accretions	(9,795)	(13,845)
Deletions	(8,704)	(19,915)
Ending balance	$ 55,997	$ 98,088

Additions primarily represent reclasses from nonaccretable difference to accretable yield on the portfolios. Deletions represent loan impairments and disposal of loans, which includes foreclosure of underlying collateral and result in the removal of the loans from the accretable yield portfolios as well as recoveries of loan impairments if conditions change or improve. As the Company continues to obtain additional information related to the expected cash flows on the acquired loans, the accretable yield may change. Therefore, the amounts of accretable income recorded for the three months ended February 28, 2014, are not necessarily indicative of the results to be expected in the future.

Loans Held-For-Sale – During the three months ended February 28, 2014, the Company originated loans with a total principal balance of $295.5 million and sold $253.0 million of originated loans into two separate securitizations. An additional $49.2 million of originated loans were sold into a securitization trust at

February 28, 2014, but not yet closed as of February 28, 2014, and thus, the sale price of these loans was included as Receivables, net in the accompanying consolidated balance sheets. $109.3 million of originated loans were sold into a securitization trust but not yet closed as of November 30, 2013, and thus, were included as Receivables, net in the accompanying consolidated balance sheets.

5. ALLOWANCE FOR LOAN LOSSES

The allowance for loan losses is a valuation reserve established through provisions for loan losses charged against income. The allowance for loan losses is maintained at a level that management deems sufficient to absorb probable losses inherent in the loan portfolio. Loans deemed to be uncollectible are charged against the allowance for loan losses, while recoveries of previously charged-off amounts are credited to the allowance for loan losses.

The following table shows the activity related to the allowance for loan losses for the three months ended February 28, 2014 and 2013 (in thousands):

	Three Months Ended February 28, 2014			Three Months Ended February 28, 2013		
	Accrual	Nonaccrual	Total	Accrual	Nonaccrual	Total
Beginning balance	$ 18,952	$ 1,213	$ 20,165	$ 12,178	$ 3,722	$ 15,900
Provision for loan losses	6,637	79	6,716	6,077	1,013	7,090
Charge-offs	(667)	(868)	(1,535)	(1,404)	(3,025)	(4,429)
Ending balance	$ 24,922	$ 424	$ 25,346	$ 16,851	$ 1,710	$ 18,561

At February 28, 2014 and November 30, 2013, the carrying value of loans accounted for under ASC 310-30 totaled approximately $259.6 million and $270.1 million, respectively, and was assessed for impairment at the pool level. The Company's homogeneous pools are comprised of loans with similar characteristics such as loan type and the geographical location of the underlying collateral. At February 28, 2014 and November 30, 2013, the Company had approximately $24.9 million and $19.0 million, respectively, of allowance for loan losses against loans of this type. For the three months ended February 28, 2014, included in Provision for loan losses were $3.0 million of reversals for accretable pools that were determined to no longer require an impairment reserve. There was no such reversal for the three months ended February 28, 2013.

At February 28, 2014 and November 30, 2013, there were loans receivable with a carrying value of approximately $5.9 million and $8.3 million, respectively, which are considered impaired under ASC 310-10, and for which interest income was not being recognized as they were classified as nonaccrual. At February 28, 2014 and November 30, 2013, the Company had approximately $0.4 million and $1.2 million, respectively, of allowance for loan losses against the nonaccrual loans.

When forecasted principal and interest cannot be reasonably estimated at the loan acquisition date, management classifies the loan as nonaccrual and accounts for these assets in accordance with ASC 310-10. When a loan is classified as nonaccrual, any subsequent cash receipt is accounted for using the cost recovery method. In accordance with ASC 310-10, a loan is considered impaired when based on current information and events it is probable that all amounts due according to the contractual terms of the loan agreement will not be collected. Although these loans met the definition of ASC 310-10, these loans were not considered impaired relative to the Company's recorded investment at the time of acquisition since they were acquired at a substantial discount to their unpaid principal balance. A provision for loan losses is recognized when the recorded investment in the loan is in excess of its fair value. The fair value of the loan is determined by using either the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral less estimated costs to sell.

The following tables represent nonaccrual loans in the FDIC Portfolios and Bank Portfolios accounted for under ASC 310-10 aggregated by collateral type at February 28, 2014 and November 30, 2013 (in thousands):

	February 28, 2014			
	Unpaid	Recorded Investment		Total
Collateral Type	Principal Balance	With Allowance	Without Allowance	Recorded Investment
Land	$ 5,201	$ -	$ 2,136	$ 2,136
Single family homes	9,950	502	2,627	3,129
Commercial properties	1,500	587	-	587
Total	$ 16,651	$ 1,089	$ 4,763	$ 5,852

	November 30, 2013			
	Unpaid	Recorded Investment		Total
Collateral Type	Principal Balance	With Allowance	Without Allowance	Recorded Investment
Land	$ 6,791	$ 249	$ 2,304	$ 2,553
Single family homes	15,125	519	4,119	4,638
Commercial properties	3,400	498	628	1,126
Total	$ 25,316	$ 1,266	$ 7,051	$ 8,317

The average recorded investment in impaired loans totaled approximately $7.1 million and $37.2 million, respectively, for the three months ended February 28, 2014 and 2013.

The loans receivable portfolios consist of loans acquired at a discount. Based on the nature of these loans, the portfolios are managed by assessing the risks related to the likelihood of collection of payments from borrowers and guarantors, as well as monitoring the value of the underlying collateral. The following are the risk categories for the loans receivable portfolios:

Accrual - Loans in which forecasted cash flows under the loan agreement, as it might be modified from time to time, can be reasonably estimated at the date of acquisition. The risk associated with loans in this category relates to the possible default by the borrower with respect to principal and interest payments and thus a decline in the forecasted cash flows used to determine accretable yield income and the recognition of impairment through an allowance for loan losses.

Nonaccrual - Loans in which forecasted principal and interest could not be reasonably estimated at the date of acquisition. Although the Company believes the recorded investment balance will ultimately be realized, the risk of nonaccrual loans relates to a decline in the value of the collateral securing the outstanding obligation and the recognition of impairment through an allowance for loan losses if the recorded investment in the loan exceeds the fair value of the collateral.

Risk categories net of allowance for loan losses at February 28, 2014 and November 30, 2013 (in thousands):

	February 28, 2014		
Collateral Type	**Accrual**	**Nonaccrual**	**Total**
Land	$ 155,877	$ 2,136	$ 158,013
Single family homes	52,145	3,129	55,274
Commercial properties	38,516	587	39,103
Other	13,029	-	13,029
Total	$ 259,567	$ 5,852	$ 265,419

	November 30, 2013		
Collateral Type	**Accrual**	**Nonaccrual**	**Total**
Land	$ 164,397	$ 2,553	$ 166,950
Single family homes	55,009	4,638	59,647
Commercial properties	36,934	1,126	38,060
Other	13,735	-	13,735
Total	$ 270,075	$ 8,317	$ 278,392

In order to assess the risk associated with each risk category, the Company evaluates the forecasted cash flows and the value of the underlying collateral securing loans receivable on a quarterly basis or when an event occurs that suggests a decline in the assets' fair value.

6. REAL ESTATE OWNED

The acquisition of properties acquired through, or in lieu of, loan foreclosure are reported within the consolidated balance sheets as REO held-and-used, net and REO held-for-sale. When a property is determined to be held-and-used, net, the asset is recorded at fair value and depreciated over its useful life using the straight line method. When certain criteria set forth in ASC 360, *Property, Plant and Equipment*, ("ASC 360"), are met; the property is classified as held-for-sale. When a real estate asset is classified as held-for-sale, the property is recorded at the lower of its cost basis or fair value less estimated costs to sell. The fair value of REO held-for-sale are determined in part by placing reliance on third party appraisals of the properties and/or internally prepared analyses of recent offers or prices on comparable properties in the proximate vicinity.

Upon the acquisition of REO through loan foreclosure, gains and losses are recorded in REO expense in the accompanying consolidated statements of operations. The amount by which the recorded investment in the loan is less than the REO's fair value (net of estimated cost to sell if held-for-sale), is recorded as an unrealized gain upon foreclosure. The amount by which the recorded investment in the loan is greater than the REO's fair value (net of estimated cost to sell if held-for-sale) is recorded as a provision for loan losses for nonaccrual loans and as an unrealized loss within Other REO expense, net for accrual loans.

At times, the Company may foreclose on a loan from an accrual loan pool in which the removal of the loan does not cause an overall decrease in the expected cash flows of the loan pool, and as such, no provision for loan losses is required to be recorded. However, the amount by which the recorded investment in the loan is greater than the REO's fair value (net of estimated cost to sell if held-for-sale) is recorded as an unrealized loss upon foreclosure.

Included in real estate owned held-and-used, net is real estate acquired in a bargain purchase acquisition of $35.0 million (see Note 7).

The following tables present the activity in REO for the three months ended February 28, 2014 and 2013 (in thousands):

	Three Months Ended February 28,	
	2014	2013
REO held-for-sale, beginning balance	$ 197,851	$ 134,161
Additions	-	594
Reserves	(386)	-
Improvements	1,593	1,016
Sales	(41,233)	(25,780)
Impairments	(1,405)	(699)
Transfer from held-and-used, net [(1)]	29,814	69,386
REO held-for-sale, ending balance	$ 186,234	$ 178,678

	Three Months Ended February 28,	
	2014	2013
REO held-and-used, net, beginning balance	$ 428,989	$ 601,022
Additions	8,034	16,192
Improvements	763	700
Impairments	(904)	(96)
Depreciation	(1,393)	(1,159)
Transfer to held-for-sale [(1)]	(29,814)	(69,386)
REO held-and-used, net, ending balance	$ 405,675	$ 547,273

[(1)] During the three months ended February 28, 2014 and 2013, the Company transferred certain properties from REO held-and-used, net to REO held-for-sale as a result of changes in the disposition strategy of the real estate assets.

For the three months ended February 28, 2014 and 2013, the Company recorded $9.5 million and $8.7 million, respectively, of net gains from sales of REO. For the same time periods, the Company recorded $(0.1) million and $1.5 million, respectively, of net unrealized (losses) gains from acquisitions of REO through foreclosure. These unrealized gains (losses) are recorded in Other REO expense, net, in the consolidated statements of operations.

7. ACQUISITIONS

Acquisition of Service Provider – Until January 2014, the Company had an approximately 5% investment in a financial services company that had a business segment that provides service and infrastructure to the residential home loan market (the “Service Provider”), and which has provided loan servicing support for the Company’s owned and managed portfolios and asset management services for the Company’s small balance loan program. In January 2014, the Company acquired 100% of this business segment of the Service Provider in exchange for the Company’s 5% interest mentioned above.

The following table outlines the assets and liabilities of the acquired business segment, net, at the time of acquisition (in thousands):

Assets acquired		
Restricted cash	$	16,974
Operating equipment		514
Deferred taxes		2,854
Goodwill		5,094
Other assets		435
Assets acquired	$	25,871
Liabilties assumed		
Accounts payable and accruals and other liabilities	$	17,554
Liabilities assumed	$	17,554
Net Assets Acquired	$	8,317

In connection with the acquisition of the Service Provider, the Company recognized goodwill at the time of acquisition of $5.1 million. No goodwill impairment was recognized for the three months ended February 28, 2014.

Acquisition of Hospital – In November 2013, in settlement of a loan acquired as part of the Company's Bank Portfolios, the Company acquired the real estate and operating entity of a hospital (the "Hospital"). This transaction was the result of a Chapter 11 reorganization plan approved on November 7, 2013. The first part of the reorganization plan required Rialto to make a $10 million cash investment that will be used to improve the hospital and emergency room facilities, provide for working capital requirements and begin to repay secured and unsecured court approved claims per the reorganization plan. The Hospital guaranteed the payment of bankruptcy administrative claims of approximately $17.5 million owed to three groups of secured and unsecured creditors. In return, the Company acquired 100% of the Hospital operating entity effective November 8, 2013 which became a fully consolidated entity of the Company.

The Company has contracted a third party hospital operating company (the "Third Party Operator") to operate and manage the hospital at a discount from their normal management fee in return for gradually acquiring an equity participation in the hospital operating company. Additionally, the confirmed reorganization plan exchanges a 20% equity interest in the entity that owns the Hospital's land and building for the administrative bankruptcy claims of several doctors who were original shareholders of the now defunct hospital. The distribution of this noncontrolling interest to these doctors was conditioned and subject to the validation of the administrative claims presented by them during bankruptcy. Furthermore, after validation of the claims, any and all distributions will be in compliance with all State and Federal healthcare regulatory requirements. As of February 28, 2014, Rialto's healthcare attorney has not concluded the exact amount of the claims that will be allowed, therefore; the noncontrolling interest has not been distributed. Rialto has the right to withhold the distribution of this noncontrolling interest until all such requirements are satisfied.

Upon profitability, each of the three secured creditor groups will receive payments of one-third of 75% of the Hospital's net income plus 50% of the earned management fees withheld from the Third Party Operator towards their claims, some of which bear interest of 0% to 5%. In addition, all excess operating cash flow beyond the scheduled payments to secured creditors shall be used to accelerate payment in full of all of these claims. Neither Rialto nor the Third Party Operator shall receive any distribution from operations other than the reduced management fee and payments until all three groups of secured creditors have been paid in full, which management believes can occur within 2 to 3 years.

As a result of this transaction, the Company recorded a provisional gain on acquisition of $8.5 million during the year ended November 30, 2013, primarily consisting of the difference between the fair value of the Hospital real estate collateral acquired and the carrying value of the loan receivable. The Company completed its purchase price allocation during the three months ended February 28, 2014, which did not result in any significant adjustment to the fair value of net assets acquired previously recorded.

The following table outlines the adjusted assets and liabilities of the acquired entity, net at the time of acquisition (in thousands):

Assets acquired		
Real estate owned - held-and-used, net	$	34,789
Operating equipment		4,058
Other assets		7,438
Assets acquired	$	46,285
Liabilties assumed		
Accounts payable and accruals and other liabilities	$	4,521
Notes payable		12,397
Noncontrolling interest		3,360
Liabilities assumed	$	20,278
Net Assets Acquired	$	26,007

8. INVESTMENTS

Investments Held-to-Maturity

Commercial Mortgage Backed Securities - A non-investment grade CMBS totaling $43 million was acquired in 2010 for $19.4 million, representing a 55% discount to par value. These securities bear interest at a coupon rate of 4% and have a stated and assumed final distribution date of November 2020 and a stated maturity date of October 2057. The Company reviews changes in estimated cash flows periodically, to determine if other-than-temporary impairment has occurred on its investment securities. Based on the Company’s assessment, no impairment charges were recorded during the three months ended February 28, 2014 and 2013. The carrying value of the investment securities at February 28, 2014 and November 30, 2013 was $16.4 million and $16.1 million, respectively. The fair value of the investment securities at February 28, 2014 and November 30, 2013, was $16.2 million and $16.0 million, respectively. The Company classified these securities as held-to-maturity based on its intent and ability to hold the securities until maturity.

In a CMBS transaction, monthly interest received from all of the pooled loans is paid to the investors, starting with those investors holding the highest rated bonds and progressing in an order of seniority based on the class of security. Based on the aforementioned, the principal and interest repayments of a particular class are dependent upon collections on the underlying mortgages, which are affected by prepayments, extensions and defaults.

Investments in Unconsolidated Entities

Investment Funds

Fund I – In 2010, the Company completed its first closing of Fund I. Fund I's objective was to invest in distressed real estate assets and other related investments that fit within Fund I's investment parameters. As of November 30, 2013, the total equity commitments of Fund I were $700 million (including $75 million committed and contributed by the Company.) All capital commitments have been called, funded and invested. In addition, approximately $330 million of proceeds from underlying asset activities and financings were recycled and invested. Fund I has been closed to additional commitments. During the three months ended February 28, 2014 and 2013, the Company received distributions of $3.2 million and $7.7 million, respectively, as a return of capital. As of February 28, 2014 and November 30, 2013, the carrying value of the Company's investment in Fund I was $77.6 million and $75.7 million, respectively. During the three months ended February 28, 2014 and 2013, the Company's share of earnings from Fund I was $5.1 million and $6.4 million, respectively.

If Fund I had ceased operations and liquidated all its investments for their estimated fair values on February 28, 2014, the Company would have received $90.2 million with regard to the Company's Carried Interest. However, Fund I did not cease operations and liquidate its investments on February 28, 2014, and the ultimate sum the Company will receive with regard to the Company's Carried Interest in Fund I may be substantially higher or lower than $90.2 million. No amount has been recorded in the Company's consolidated statement of operations with regard to the Company's Carried Interest in Fund I. See Note 2, Summary of Significant Accounting Policies in the notes to the consolidated financial statements for more information on how the Company records revenues attributable to Carried Interest.

Fund II – In 2013, the Company conducted the first closing of commitments of Fund II. Fund II's objective during its commitment period is to acquire and manage distressed and other value-add real estate assets and other related investments that fit Fund II's investment parameters. Among other things, Fund II's documents prohibit the Company from acquiring real estate assets that might be suitable for Fund II, before Fund II is fully invested or committed. As of February 28, 2014, Fund II was closed to additional commitments with equity commitments of $1.3 billion, including $100 million by the Company. As of February 28, 2014, $660 million of the $1.3 billion in equity commitments had been called, of which, the Company contributed its portion of $50.6 million. During the three months ended February 28, 2014, $148.6 million in equity commitments was called, none of which was called from the Company due to new investors coming in to Fund II. During the three months ended February 28, 2014, the Company received distributions of $2.0 million as a return of capital from Fund II. As of February 28, 2014 and November 30, 2013, the carrying value of the Company's investment in Fund II was $51.2 million and $53.1 million, respectively. For the three months ended February 28, 2014, the Company's share of earnings from Fund II was approximately zero.

Mezzanine Fund – In 2013, the Company started raising capital and investing in mezzanine commercial loans creating the Mezzanine Fund with a target of raising $300 million in capital to invest in performing mezzanine commercial loans. These loans have expected durations of one to two years and are secured by equity interests in the borrowing entity owning the real estate. As of February 28, 2014, the Mezzanine Fund had total equity commitments and capital invested of $82 million, including $25 million committed and invested by the Company, of which $8.6 million was contributed by the Company during three months ended February 28, 2014. As of February 28, 2014 and November 30, 2013, the carrying value of the Company's investment in the Mezzanine Fund was $25.6 million and $16.7 million, respectively. For the three months ended February 28, 2014, the Company's share of earnings from the Mezzanine Fund was $0.3 million.

CMBS Fund – In 2014, the Company created CMBS Fund. The general purpose of the CMBS Fund is to acquire, own and/or monetize commercial mortgage-backed securities with at least some portion of the collateral being originated by the RMF business line. As of February 28, 2014, the CMBS Fund had total invested capital of $14.7 million, including $9.7 million committed by the Company. As of February 28, 2014, the carrying value of the Company's investment in the CMBS Fund was $9.7 million. For the three months ended February 28, 2014, the Company's share of earnings was approximately zero.

Fund I, Fund II, the Mezzanine Fund and the CMBS Fund are unconsolidated entities and are accounted for under the equity method of accounting. They were determined to have the attributes of an investment company in accordance with ASC 946, *Financial Services - Investment Companies*, ("ASC 946"), as amended by ASU 2013-08, the attributes of which are different from the attributes that would cause a company to be an investment company for purposes of the Investment Company Act of 1940. As a result, Fund I, Fund II, the Mezzanine Fund and the CMBS Fund's assets and liabilities are recorded at fair value with increases/decreases in fair value recorded in their respective statement of operations, the Company's share of which will be recorded in equity in earnings from unconsolidated entities in the accompanying consolidated statements of operations. The Company determined that Fund I, Fund II, the Mezzanine Fund and the CMBS Fund are not variable interest entities but rather voting interest entities due to the following factors:

- The Company determined that Rialto's general partner interest and all the limited partners' interests qualify as equity investment at risk.
- Based on the capital structure of Fund I, Fund II, the Mezzanine Fund and the CMBS Fund (100% capitalized via equity contributions), the Company was able to conclude that the equity investment at risk was sufficient to allow Fund I, Fund II, the Mezzanine Fund and the CMBS Fund to finance its activities without additional subordinated financial support.
- The general partner and the limited partners in Fund I, Fund II, the Mezzanine Fund and the CMBS Fund, collectively, have full decision-making ability as they collectively have the power to direct the activities of Fund I, Fund II, the Mezzanine Fund and the CMBS Fund, due to the fact that Rialto, in addition to being a general partner with a substantive equity investment in Fund I, Fund II, the Mezzanine Fund and the CMBS Fund, also provides services to Fund I, Fund II, the Mezzanine Fund and the CMBS Fund under a management agreement and an investment agreement, which are not separable from Rialto's general partnership interest.
- As a result of all these factors, the Company has concluded that the power to direct the activities of Fund I, Fund II, the Mezzanine Fund and the CMBS Fund reside in its general partnership interest and thus with the holders of the equity investment at risk.
- In addition, there are no guaranteed returns provided to the equity investors and the equity contributions are fully subjected to Fund I, Fund II, the Mezzanine Fund and the CMBS Fund's operational results, thus the equity investors absorb the expected negative and positive variability relative to Fund I, Fund II, the Mezzanine Fund and the CMBS Fund.
- Finally, substantially all of the activities of Fund I, Fund II, the Mezzanine Fund and the CMBS Fund are not conducted on behalf of any individual investor or related group that has disproportionately few voting rights (i.e., on behalf of any individual limited partner).

Having concluded that Fund I, Fund II, the Mezzanine Fund and the CMBS Fund are voting interest entities, the Company evaluated the funds under the voting interest entity model to determine whether, as general partner, it has control over Fund I, Fund II, the Mezzanine Fund and the CMBS Fund. The Company determined that it does not control Fund I, Fund II, the Mezzanine Fund and the CMBS Fund as its general partner, because the unaffiliated limited partners have substantial kick-out rights and can remove Rialto as general partner at any time for cause or without cause through a simple majority vote of the limited partners. In addition, there are no significant barriers to the exercise of these rights. As a result of determining that the

Company does not control Fund I, Fund II, the Mezzanine Fund and the CMBS Fund under the voting interest entity model, Fund I, Fund II, the Mezzanine Fund and the CMBS Fund are not consolidated in the Company's financial statements.

A summary of Rialto's investment in unconsolidated entities as of February 28, 2014 and November 30, 2013, is as follows (in thousands):

	February 28, 2014	November 30, 2013
Fund I	$ 77,560	$ 75,729
Fund II	51,187	53,103
Mezzanine Fund	25,642	16,724
CMBS Fund	9,681	-
Other	689	694
Service Provider (see Note 7)	-	8,323
	$ 164,759	$ 154,573

Summarized Condensed Financial Information

On a consolidated 100% basis related to Rialto's investments in unconsolidated entities that are accounted for by the equity method was as follows as of February 28, 2014 and November 30, 2013, and for the three months ended February 28, 2014 and 2013 (in thousands):

Balance Sheets

	February 28, 2014	November 30, 2013
Assets:		
Cash and cash equivalents	$ 234,811	$ 332,968
Loans receivable	585,271	523,249
Real estate owned	321,928	285,565
Investments in partnerships	238,935	149,350
Investment securities	436,234	381,555
Other assets	28,415	191,624
	$ 1,845,594	$ 1,864,311
Liabilities and equity:		
Accounts payable and other liabilities	$ 30,725	$ 108,514
Notes payable	317,306	398,445
Partner loans	-	163,940
Equity	1,497,563	1,193,412
	$ 1,845,594	$ 1,864,311

Statements of Operations

	Three Months Ended February 28, 2014	Three Months Ended February 28, 2013
Revenues	$ 31,427	$ 53,343
Costs and expenses	26,109	59,114
Other income, net [(1)]	48,170	56,001
Net earnings of unconsolidated entities	$ 53,488	$ 50,230
Equity in earnings from unconsolidated entities	$ 5,354	$ 6,173

[(1)] Other income, net for the three months ended February 28, 2014, includes Fund I and Fund II's realized and unrealized gains on investments as well as other income from REO. Other income, net for the three months ended February 28, 2013, includes the PPIP Fund's mark-to-market unrealized gains and losses, of which the Company's portion was a small percentage. Also included is Fund I's realized and unrealized gains on investments as well as other income from REO.

9. OTHER ASSETS - NET

The Company's other assets – net consisted of the following at February 28, 2014 and November 30, 2013 (in thousands):

	February 28, 2014	November 30, 2013
Management fee receivables from related parties	$ 7,827	$ 8,200
Debt issuance costs - net	6,631	6,910
Operating equipment	11,384	14,959
Accounts receivable	13,913	7,653
Deposits and other	15,449	5,566
Total other assets - net	$ 55,204	$ 43,288

10. NOTES PAYABLE AND OTHER DEBTS PAYABLE

The Company's notes payable and other debts payable consisted of the following at February 28, 2014 and November 30, 2013 (in thousands):

	February 28, 2014	November 30, 2013
Senior Notes	$ 250,000	$ 250,000
Bank Portfolios	90,933	90,933
Warehouse Repurchase Facilities	57,848	76,017
Notes payable - other	22,977	24,933
Total Notes payable and other debts payable	$ 421,758	$ 441,883

In November 2013, the Company issued $250 million aggregate principal amount of 7.00% senior notes due 2018 (the "7.00% Senior Notes"), at a price of 100% in a private placement. Proceeds from the offering, after payment of expenses, were approximately $245 million. The Company used $100 million of the net proceeds from the sale of the 7.00% Senior Notes, and subsequently an additional $135 million of working capital, to repay sums that were previously advanced to the Company by Lennar. Interest on the 7.00%

Senior Notes is due on June 1 and December 1 of each year, and the 7.00% Senior Notes will mature on December 1, 2018. At February 28, 2014, the carrying amount of the 7.00% Senior Notes were $250 million.

The Company may redeem all or a portion of the 7.00% Senior Notes at the following redemption prices (expressed as a percentage of principal) beginning December 1 of each of the years indicated below:

Year	Percentage
2015	103.50%
2016	101.75%
2017	100.00%

The Company must also pay any accrued and unpaid interest through, but not including, the date of redemption. The Company may redeem all or a portion of the 7.00% Senior Notes at any time, before December 1, 2015, at a redemption price equal to 100% of the principal amount, plus a make-whole premium and accrued and unpaid interest. Before December 1, 2015, the Company may redeem up to 35% of the aggregate principal amount of the 7.00% Senior Notes with the proceeds of public offerings of equity at a redemption price equal to 107% of the principal amount of the 7.00% Senior Notes, plus accrued and unpaid interest.

Under the indenture governing the 7.00% Senior Notes, the Company is subject to certain covenants limiting, among other things, the Company's ability to incur indebtedness, to make investments, to make distributions to, or enter into transactions with, Lennar or to create liens subject to certain exceptions and qualifications. The Company is in compliance with all debt covenants as of February 28, 2014.

The 7.00% Senior Notes are Rialto's senior unsecured and unsubordinated obligations, rank equally with all of Rialto's other unsecured and unsubordinated indebtedness, and are senior to any of Rialto's future indebtedness that is expressly subordinated in right of payment to the 7.00% Senior Notes and junior to any of Rialto's secured indebtedness to the extent of the value of the assets securing that indebtedness. The Rialto 7.00% Senior Notes are guaranteed by existing and future directly or indirectly 100% owned subsidiaries other than subsidiaries which Rialto designates as unrestricted subsidiaries (which subject those subsidiaries to limits on investments by the Company and other restrictions). A 100% owned subsidiary can only become an unrestricted subsidiary if it is a borrower under a warehouse repurchase facility or is prevented from guaranteeing the 7.00% Senior Notes by any applicable law, regulation or contractual restriction which cannot be removed through commercially reasonable efforts.

Upon a Change of Control Triggering Event, the Company will be required to make an offer to repurchase all the outstanding 7.00% Senior Notes at a price in cash equal to 101% of the principal amount of the 7.00% Senior Notes, plus any accrued and unpaid interest to, but not including, the repurchase date. See further discussion of how the 7.00% Senior Notes affected the Company's relationship with Lennar in Note 15.

Subsequent to quarter end, the Company issued an additional $100 million aggregate principal amount, as an add-on to the 7.00% Senior Notes, at a price of 102.25%, in a private placement. The terms from the add-on offering have identical terms as the 7.00% Senior Notes. Proceeds from the offering, after payment of expenses, were approximately $101.7 million. The Company intends to use most of the funds to provide additional working capital to its RMF business, in addition to funding contributions to its investment funds or for other general corporate purposes.

During 2013 the Company also secured an additional $75 million revolving credit agreement with Lennar. Under the revolving credit agreement, Lennar will, as requested by the Company and subject to customary lending conditions, make advances to the Company on a revolving basis of up to $75 million. The maturity date will be two years from the date of signing and the Company will pay interest on the advances at a rate of LIBOR plus 3.5%. The Company is subject to certain customary covenants, including, but not limited to, limitations on fundamental changes, limitations on changes to line of business and transactions with affiliates. The Company may prepay outstanding amounts at any time, without premium or penalty, on 10 business days' prior notice. The Company and Lennar may mutually agree to amend or terminate such credit agreement at any time. At February 28, 2014, no amounts were outstanding under this agreement and no amounts had been borrowed or repaid under this agreement.

In September 2010, the Company acquired approximately 400 distressed residential and commercial real estate loans ("Bank Portfolios") and over 300 REO properties from three financial institutions. The Company paid $310 million for the distressed real estate and real estate related assets of which $124 million was financed through a 5-year senior unsecured note provided by one of the selling institutions of which $33.0 million of principal amount was retired in 2012. The Bank Portfolios' notes payable have an interest rate of the higher of 4.5% or 1 month LIBOR plus 3.75%. As of both February 28, 2014 and November 30, 2013, there was $90.9 million outstanding.

In January 2014, the Company extended the maturity date of the Bank Portfolio's note payable from September 30, 2013 to September 30, 2016. Additionally, in February 2014, the Company rescheduled the three remaining principal payments of $30.3 million to be due on December 15, 2014, 2015 and 2016.

As of November 30, 2013, the Company had secured two warehouse repurchase financing agreements for use in the RMF business that mature in in fiscal year 2015 totaling $500 million to help finance the loans the Company originates. The first facility has a maturity date of August 9, 2015 with an option for a one time, one year extension. The second Facility has a maturity date of October 8, 2015 with an option for a one time, one year extension. These Facilities are in the form of two separate repurchase agreements, and each is secured by a 75% interest in the originated commercial loans financed under the Facility. These Facilities bear interest at LIBOR plus 2.25% (with a LIBOR floor of 0.25%) calculated on the then outstanding principal amount (2.5% at February 28, 2014). The Facilities require the Company to maintain a minimum liquidity, tangible net worth, interest coverage and debt to equity ratios. The Company is in compliance with all debt covenants as of February 28, 2014. The Facilities require immediate repayment of the 75% interest in the secured commercial loans when the loans are sold in a securitization. As of February 28, 2014 and November 30, 2013, the Company had $57.8 million and $76.0 million, respectively, outstanding under the Facilities.

On January 31, 2011, the Company obtained a monetary judgment on an unpaid principal balance of a loan receivable. Effective May 2, 2011, the Company entered into a settlement agreement in consideration for a stay of execution on the monetary judgment and agreed to accept the conveyance of full and partial ownership interests in entities that own numerous real estate assets. The real estate assets are comprised primarily of commercial office buildings. At the time the Company acquired these ownership interests, the underlying assets had a fair value of approximately $20.5 million including the assumption of notes payable totaling approximately $15.1 million which are reflected within Notes payable – other, in the table above. As part of the settlement agreement, the Company also accepted a secured promissory note receivable in the amount of $2.5 million from the obligor which is included in the Company's consolidated balance sheet within Loans receivable, net. The note bears interest at 5% per annum and requires interest only payments of $125,000 over the next five years with the principal amount due on May 30, 2016. The $2.5 million promissory note is secured by a stock pledge and pledge of cash distributions from additional commercial office building assets, of which the obligor is an owner.

See Note 7 for further discussion of the remaining notes payable included in the notes payable – other line item above.

In connection with the acquisition of the FDIC Portfolios, the FDIC provided $626.9 million of financing with 0% interest, which was non-recourse to the Company and the LLCs and has been paid off as of November 30, 2013. Pursuant to ASC 835-30, *Imputed Interest*, ("ASC 835-30"), interest was not imputed, as the Notes were issued and guaranteed by a governmental agency. The notes were secured by the loans held by the LLCs. Additionally, if the LLCs exceed expectations and meet certain internal rate of return and distribution thresholds, the Company's equity interest in the LLCs could be reduced from 40% down to 30%, with a corresponding increase to the FDIC's equity interest from 60% to 70%. As of November 30, 2013, the notes payable had been fully paid and the remaining cash collected on the loans and REO properties, net of expenses and other items, are being shared 60% / 40% with the FDIC. During the three months ended February 28, 2013, the LLCs retired $302.8 million of principal amount of notes payable under the agreement with the FDIC through the defeasance account. During the three months ended February 28, 2014, $53.1 million had been distributed by the LLCs, of which $31.9 million was paid to the FDIC and $21.2 million was paid to the Company.

Notes payable and other debts payable have interest rates ranging from 0.00% to 7.00%, and mature as follows as of February 28, 2014 (in thousands):

Year	Amount
2014	$ 64,107
2015	35,681
2016	39,289
2017	31,462
2018	251,173
Thereafter	46
Total Notes payable and other debts payable	$ 421,758

11. OTHER REO EXPENSE, NET

The Company's Other REO expense, net consisted of the following for the three months ended February 28, 2014 and 2013 (in thousands):

	February 28, 2014	February 28, 2013
Realized gains on the sale of REO	$ (9,509)	$ (8,671)
Unrealized losses (gains) on loan foreclosure	68	(1,465)
Impairment on REO	2,309	795
REO expenses	11,864	12,556
Other REO expense, net	$ 4,732	$ 3,215

12. FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS

The following table presents the carrying amounts and estimated fair values of financial instruments held by the Company at February 28, 2014 and November 30, 2013 (in thousands), respectively, using available market information and what the Company believes to be appropriate valuation methodologies. Considerable judgment is required in interpreting market data to develop the estimates of fair value. The use of different market assumptions and/or estimation methodologies might have a material effect on the estimated fair value amounts. The table excludes cash, restricted cash, receivables, net, accounts payable and due to Parent, which had fair values approximating their carrying amounts due to the short maturities and liquidity of these instruments.

Assets	Fair Value Hierarchy	February 28, 2014 Carrying Amount	February 28, 2014 Fair Value	November 30, 2013 Carrying Amount	November 30, 2013 Fair Value
Loans receivable, net	Level 3	$ 265,419	$ 290,386	$ 278,392	$ 305,810
Investments held-to-maturity	Level 3	$ 16,359	$ 16,245	$ 16,070	$ 15,952
Liabilities					
Notes payable and other debts payable	Level 2	$ 363,910	$ 357,700	$ 365,866	$ 362,356
Warehouse repurchase facilities	Level 2	$ 57,848	$ 57,848	$ 76,017	$ 76,017

The following methods and assumptions are used by the Company in estimating fair value:

Loans Receivable, net - The fair value of loans receivable, net is based on discounted cash flows as of February 28, 2014 and November 30, 2013, respectively, or the fair value of the underlying collateral less estimated cost to sell.

Investments Held-to-Maturity - The fair value for investments held-to-maturity is based on discounted cash flows.

Notes Payable and other debts payable - The fair value of notes payable was calculated based on discounted cash flows using the Company's weighted average borrowing rate.

Warehouse Repurchase Facilities - The fair value of the warehouse repurchase facilities is assumed to approximate its carrying value because of its short duration and variable interest rates.

Loans Held-for-Sale - The fair value of loans held-for-sale is calculated from model-based techniques that use discounted cash flow assumptions and the Company's own estimates of CMBS spreads, market interest rate movements and the underlying loan credit quality. Loan values are calculated by allocating the change in value of an assumed CMBS capital structure to each loan. The value of an assumed CMBS capital structure is calculated, generally, by discounting the cash flows associated with each CMBS class at market interest rates and at the Company's own estimate of CMBS spreads. The Company estimates CMBS spreads by observing the pricing of recent CMBS offerings, secondary CMBS markets, changes in the CMBX index, and general capital and commercial real estate market conditions. Considerations in estimating CMBS spreads include comparing the Company's current loan portfolio with comparable CMBS offerings containing loans with similar duration, credit quality and collateral composition. These methods use unobservable inputs in estimating a discount rate that is used to assign a value to each loan. While the cash payments on the loans are contractual, the discount rate used and assumptions regarding the relative size of each class in the CMBS capital structure can significantly impact the valuation. Therefore, the estimates used could differ materially from the fair value determined when the loans are sold to a securitization trust.

Interest Rate Swaps and Swap Futures – The fair value of interest rate swaps and swap futures (derivatives) is based on quoted market prices for identical investments traded in active markets.

Credit Default Swaps – The fair value of credit default swaps (derivatives) is based on quoted market prices for similar investments traded in active markets.

Fair Value Measurements - Authoritative accounting literature establishes a framework for using fair value to measure assets and liabilities and defines fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) as opposed to the price that would be paid to acquire the asset or received to assume the liability (an entry price). A fair value measure should reflect the assumptions that market participants would use in pricing the asset or liability, including the assumptions about the risk inherent in a particular valuation technique, the effect of a restriction on the sale or use of an asset, and the risk of nonperformance. Required disclosures include stratification of balance sheet amounts measured at fair value based on inputs the Company uses to derive fair value measurements. These levels include:

- *Level 1* valuations, where the valuation is based on quoted market prices for identical assets or liabilities traded in active markets (which include exchanges and over-the-counter markets with sufficient volume).

- *Level 2* valuations, where the valuation is based on quoted market prices for similar instruments traded in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

- *Level 3* valuations, where the valuation is generated from model-based techniques that use significant assumptions not observable in the market, but observable based on Company-specific data. These unobservable assumptions reflect the Company's own estimates for assumptions that market participants would use in pricing the asset or liability. Valuation techniques typically include discounted cash flow models and similar techniques, but may also include the use of market prices of assets or liabilities that are not directly comparable to the subject asset or liability.

Fair Value on a Recurring Basis - Assets accounted for under ASC 825 are initially measured at fair value. Expected gains and losses from initial measurement and subsequent changes in fair value are recognized in revenue.

The Company's financial instruments measured at fair value on a recurring basis as of February 28, 2014 and November 30, 2013, are summarized below (in thousands):

	February 28, 2014		
	Fair Value Hierarchy	Fair Value	Total Gains (Losses)
Financial Assets			
Loans held-for-sale [1]	Level 3	$ 86,857	$ 553
Credit default swaps	Level 2	1,588	800
Financial Liabilities			
Interest rate swaps and swap futures	Level 1	$ 467	$ (436)
Credit default swaps	Level 2	1,146	(828)

[1] The aggregate fair value of loans held-for-sale of $86.9 million at February 28, 2014 exceeds their aggregate principal balance of $86.4 million by $0.5 million.

	November 30, 2013		
	Fair Value Hierarchy	Fair Value	Total Gains (Losses)
Financial Assets			
Loans held-for-sale [(1)]	Level 3	$ 44,228	$ 33
Credit default swaps	Level 2	788	788
Financial Liabilities			
Interest rate swap futures	Level 1	$ 31	$ (31)
Credit default swaps	Level 2	318	(318)

[(1)] The aggregate fair value of loans held-for-sale of $44.2 million at November 30, 2013, exceeds their aggregate principal balance of $44.0 million by $0.2 million.

The following table represents a reconciliation of the beginning and ending balance for the Company's Level 3 recurring fair value measurements of loans held-for-sale (in thousands):

	February 28, 2014
Loans held-for-sale, beginning of period	$ 44,228
Loan originations	295,508
Originated loans sold, including those not settled	(253,038)
Interest and principal paydowns	(394)
Changes in fair value	553
Loans held-for-sale, end of period	$ 86,857

Fair Value on a Nonrecurring Basis - From time to time, certain assets may be recorded at fair value on a nonrecurring basis. These nonrecurring fair value adjustments typically are a result of real estate acquisition through foreclosure, the application of the lower of cost or fair value accounting and impairments. For example, if the fair value of an asset in these categories falls below its cost basis, it is considered to be at fair value at the end of the period of the adjustment. In periods where there is no adjustment, the asset is generally not considered to be at fair value. The assets measured at fair value on a nonrecurring basis are summarized below (in thousands):

	February 28, 2014		
	Fair Value Hierarchy	Fair Value	Total Net Losses
Financial Assets			
Impaired loans receivable	Level 3	$ 169,405	$ (6,717)
Non-Financial Assets			
REO - held-and-used, net [(1)]	Level 3	$ 16,679	$ (586)
REO - held-for-sale [(2)]	Level 3	23,960	(1,791)

[(1)] REO - held-and-used, net, assets are initially recorded at fair value at the time of acquisition through, or in lieu of, loan foreclosure. Upon acquisition, the REO, held-and-used, net, had a carrying value of $7.7 million and a fair value of $8.0 million. The fair value of REO, held-and-used, net, is based upon the appraised value at the time of foreclosure or management's best estimate. The gains upon acquisition of REO, held-and-used, net, were $0.3 million. As part of management's periodic valuations of its REO, held-and-used, net, during the three months ended February 28, 2014, REO, held-and-used, net, with an aggregate value of $9.5 million were written down to their fair value of $8.6 million, resulting in impairments of $0.9 million. These gains and impairments are included within Other REO expense, net, in the Company's consolidated statement of operations for the three months ended February 28, 2014.

(2) REO - held-for-sale, assets are initially recorded at fair value less estimated costs to sell at the time of transfer. Upon transfer from REO, held-and-used, net, the REO, held-for-sale, had a carrying value of $6.4 million and a fair value of $6.0 million. The fair value of REO, held-for-sale, is based upon the appraised value at the time of transfer or management's best estimate. The losses upon transfer of REO, held-for-sale, were $0.4 million. As part of management's periodic valuations of its REO, held-for-sale, during the three months ended February 28, 2014, REO, held-for-sale, with an aggregate value of $19.3 million were written down to their fair value of $17.9 million, resulting in impairments of $1.4 million. These losses and impairments are included within Other REO expense, net, in the Company's consolidated statement of operations for the three months ended February 28, 2014.

	November 30, 2013		
	Fair Value Hierarchy	Fair Value	Total Losses
Financial Assets			
Impaired loans receivable	Level 3	$ 221,690	$ (16,139)
Non-Financial Assets			
REO - held-and-used, net [1]	Level 3	$ 98,488	$ (4,030)
REO - held-for-sale [2]	Level 3	37,185	(3,955)

(1) REO - held-and-used, net, assets are initially recorded at fair value at the time of acquisition through, or in lieu of, loan foreclosure. Upon acquisition, the REO, held-and-used, net, had a carrying value of $79.8 million and a fair value of $86.3 million. The fair value of REO, held-and-used, net, is based upon the appraised value at the time of foreclosure or management's best estimate. The gains upon acquisition of REO, held-and-used, net, were $6.5 million. As part of management's periodic valuations of its REO, held-and-used, net, during the year ended November 30, 2013, REO, held-and-used, net, with an aggregate value of $22.7 million were written down to their fair value of $12.2 million, resulting in impairments of $10.5 million. These gains and impairments are included within Other REO expense, net in the Company's consolidated statement of operations for the year ended November 30, 2013.

(2) REO - held-for-sale, assets are initially recorded at fair value at the time of acquisition through, or in lieu of, loan foreclosure. Upon acquisition, the REO held-for-sale, net, had a carrying value of $14.4 million and a fair value of $16.0 million. The fair value of REO held-for-sale, net, is based upon the appraised value at the time of foreclosure or management's best estimate. The gains upon acquisition of REO held-for-sale, net, were $1.6 million. As part of management's periodic valuations of its REO held-for-sale, net, during the year ended November 30, 2013, REO held-for-sale, net, with an aggregate value of $26.8 million were written down to their fair value of $21.2 million, resulting in impairments of $5.6 million. These gains and impairments are included within Other REO expense, net in the Company's consolidated statement of operations for the year ended November 30, 2013.

The following is a description of the valuation methodologies used for certain assets that are potentially recorded at fair value on a nonrecurring basis:

Loans Receivable - If impaired, the fair value of nonaccrual loans is based on discounted cash flows, or the fair value of the collateral less estimated disposition costs. If impaired, the fair value of accrual loan pools are based on discounted cash flows. The fair value of the real estate is determined through a combination of appraisals, broker opinions of value, and management's best estimate. The fair value of the underlying collateral is determined in part by placing reliance on independent third-party appraisals of the properties and/or internally prepared analysis of recent offers or prices on comparable properties in the proximate vicinity.

Real Estate Owned – Held-and-Used, net and Held-for-Sale - Real estate owned classified as held and used is initially recorded at fair value and real estate classified as held for sale is recorded at fair value less estimated disposition costs at the time of acquisition. The fair values of these assets are determined in part by placing reliance on independent third-party appraisals of the properties and/or internally prepared analysis of recent offers or prices on comparable properties in the proximate vicinity.

13. INCOME TAXES

Rialto is included in the consolidated federal income tax return of Lennar. However, in accordance with the tax sharing arrangement with Lennar, income taxes have been provided as if the Rialto reporting group filed as a separate federal consolidated group. Current income tax expense is recorded as an increase in amounts due to Parent. As such, no income tax payments are made directly by Rialto. Income taxes are accounted for in accordance with ASC 740, Income Taxes, ("ASC 740"). Under ASC 740, deferred tax assets and liabilities are determined based on temporary differences between financial reporting carrying values and tax bases of assets and liabilities, and are measured by using enacted tax rates expected to apply to taxable income in the years in which those differences are expected to reverse.

During the three months ended February 28, 2014 and 2013, the Company recorded tax provisions of $1.0 million and $0.7 million, respectively. The actual income tax differs from the "expected" tax expense for the year (computed by applying the U.S. federal corporate tax rate of 35% to earnings before income taxes) primarily due to the amount of state income taxes, net of the related federal tax benefit, and for amounts recorded for changes in tax reserves and interest expense.

A reduction of the carrying amounts of deferred tax assets by a valuation allowance is required if, based on the available evidence, it is more likely than not that such assets will not be realized. In accordance with the tax sharing arrangement with Lennar, income taxes have been provided as if the Rialto reporting group filed as a separate federal consolidated group. Therefore, the need to establish a valuation allowance for deferred tax assets is assessed periodically by the Company based on the more-likely-than-not realization threshold criterion. In the assessment for a valuation allowance, appropriate consideration is given to all positive and negative evidence related to the realization of the deferred tax assets. This assessment considers, among other matters, the nature, frequency and severity of current and cumulative losses, forecasts of future profitability and the duration of statutory carryforward periods.

As of November 30, 2013, the Company concluded that it was more likely than not that Rialto's deferred tax assets would be utilized. This conclusion was based on a detailed evaluation of all relevant evidence, both positive and negative. At February 28, 2014 and November 30, 2013, Rialto has a net deferred tax asset totaling $0.7 million and a net deferred tax liability totaling $7.8 million, respectively. As a result, no valuation allowance is required.

In accordance with the tax sharing arrangement with Lennar, for periods prior to September 1, 2013, the gross unrecognized tax benefits of Lennar were allocated to the Company on a pro rata basis based on revenues. Beginning with tax year November 30, 2013, the Company has determined that an evaluation of the Company's standalone uncertain tax positions would be more meaningful than an allocation of Lennar's uncertain tax positions. Accordingly, gross unrecognized tax benefits of Lennar will no longer be allocated but rather the Company's standalone unrecognized tax benefits will be evaluated independent of the gross unrecognized tax benefits of Lennar.

At February 28, 2014 and 2013, the Company had $0.0 million and $0.4 million respectively, of gross unrecognized tax benefits. As the Company has no unrecognized tax benefit at February 28, 2014, there is no effect on the Company's effective tax rate. As of November 30, 2013, the Company did not have any amount accrued for interest and penalties. The Company recognizes interest and penalties accrued related to unrecognized tax benefits in the provision for income taxes.

The IRS is currently examining Lennar's federal income tax return for fiscal year 2012 which includes the results of the Company. Additionally, certain state taxing authorities are examining various fiscal years of Lennar. The final outcome of these examinations is not yet determinable. The statute of limitations for Lennar and the Company's major tax jurisdictions remains open for examination for fiscal year 2005 and subsequent years. Lennar participates in an IRS examination program, Compliance Assurance Process, "CAP." This program operates as a contemporaneous exam throughout the year in order to keep exam cycles current and achieve a higher level of compliance.

14. COMMITMENTS AND CONTINGENT LIABILITIES

The Company is party to various claims, legal actions and complaints arising in the ordinary course of business. In the opinion of management, the disposition of these matters will not have a material adverse effect on the Company's consolidated financial statements.

The following table summarizes certain of the Company's contractual obligations at February 28, 2014 (in thousands):

		Payments Due by Period			
	Total	Less than 1 year	1 to 3 years	3 to 5 years	More than 5 years
Notes payable and other debts payable [1]	$ 363,910	$ 6,259	$ 74,970	$ 282,635	$ 46
Warehouse repurchase facilities [2]	57,848	57,848	-	-	-
Interest commitments under interest bearing debt [3]	93,053	17,377	40,468	35,187	21
Investment commitments [4]	49,421	49,421	-	-	-
RMF rate lock commitment [5]	51,700	51,700	-	-	-
Operating leases	9,732	1,148	3,825	4,759	-
Total contractual obligations	$ 625,664	$ 183,753	$ 119,263	$ 322,581	$ 67

[1] Subsequent to quarter end, the Company issued an additional $100 million aggregate principal amount, as an add-on to the 7.00% Senior Notes. This amount is not included in table above.

[2] Warehouse facilities are assumed to be paid off in the short term as soon as loans held-for-sale are securitized, which is normally within 2 to 3 months.

[3] Interest commitments on variable interest bearing debt are determined based on the interest rate as of February 28, 2014

[4] Amount includes the Company's capital commitments to Fund II.

[5] Relates to two loans the Company is contractually obligated to fund but has yet to release the funds to the borrower.

15. PARENT COMPANY TRANSACTIONS

Rialto Holdings, LLC, formed in 2013 in order to facilitate the offering of the 7.00% Senior Notes, is a direct, wholly-owned subsidiary of Lennar. Rialto Corporation, a direct, wholly-owned subsidiary of Rialto Holdings, LLC, was formed in 2013 for the sole purpose of acting as a co-issuer. However, Rialto Capital Management, LLC and Rialto Investments, LLC, each a direct, wholly-owned subsidiary of Rialto Holdings, LLC, were founded in 2007 and 2009, respectively. Prior to the 7.00% Senior Notes offering, Lennar had provided all the funds that had been used by the Company, other than funds generated from assets that were owned, or fees or proceeds of management fees the Company received. On November 14, 2013, the day the 7.00% Senior Notes were issued, Lennar contributed to the Company's equity the entire outstanding balance of the amount it had invested in the Company (an amount previously classified as "Due to Parent") in excess of $235 million. The $235 million remaining constituted indebtedness of the Company to Lennar. However, the Company applied $100 million of the gross proceeds of the sale of the 7.00% Senior Notes and $135 million of working capital to fully retire this indebtedness as of November 30, 2013.

The 7.00% Senior Notes indenture limits the ability of the Company or any of the Company's Restricted Subsidiaries (as defined in the indenture governing the 7.00% Senior Notes) to make distributions, other than the repayment of indebtedness owed, to Lennar. However, these limits will not apply at any time when the Company and its Restricted Subsidiaries have a Consolidated Non-Funding Debt to Equity Ratio (as such term is defined in the 7.00% Senior Notes Indenture dated November 14, 2013) of 1.50 to 1.00 or less.

Pursuant to the Company's Operating Agreement, the Company's sole member, Lennar, has the authority, power, and discretion to manage and control the business, affairs, and properties of the Company, to make all decisions regarding those matters and to perform any and all other acts customary or incident to the management of the Company's business. Additionally, in the Company's Operating Agreement, the Company agrees to indemnify the Company's members, manager, officers, and employees against losses, claims, damages and liabilities except in certain circumstances outlined in the Operating Agreement (i.e., in instances of gross negligence, willful misconduct or fraud).

Revolving Credit Agreement – Lennar will have no obligation to provide additional funds to the Company, other than pursuant to a revolving credit agreement between Lennar and the Company. Under the revolving credit agreement, Lennar will, subject to customary lending conditions, make advances to the Company on a revolving basis of up to $75 million. The maturity date will be November 22, 2015 and the Company will pay interest on advances at LIBOR plus 3.5% for the applicable interest period. The Company is subject to certain customary covenants, including, but not limited to, limitations on fundamental changes, limitations on changes to line of business and transactions with affiliates. The Company may repay outstanding amounts at any time, without premium or penalty, on 10 business days' prior notice, and may re-borrow sums it repays. As of February 28, 2014, no amounts were outstanding under this agreement and no amounts had been borrowed or repaid under this agreement.

Support Services and Expense Reimbursement Agreement – Prior to the 7.00% Senior Notes offering, Lennar had provided management, treasury, information technology, income tax, payroll and administrative services to the Company and to its subsidiaries. In the past, Lennar has not charged the Company for those services (although Lennar did require the Company to reimburse it for rent and other operating costs it advanced on the Company's behalf). However, on November 26, 2013, Lennar and the Company entered into a Support Services and Expense Reimbursement Agreement under which Lennar has agreed to provide specified accounting, information technology, tax, legal, human resources, treasury, occupancy, office and other administrative services to the Company and its subsidiaries and the Company will pay a fee equal to the lower of the actual cost or fair market value of those services to Lennar. As of February 28, 2014, no amounts were charged or paid by the Company under this agreement.

Tax Reimbursement Agreement – The Company and most of its subsidiaries are not recognized as taxpayers for Federal income tax purposes or for income tax purposes in some states. Instead, its taxable income and the taxable income of its subsidiaries that are limited liability companies and other types of non-corporate entities, is treated as taxable income of Lennar. Because Lennar, as the Company's sole member, is required to include at least most of the Company's Federal taxable income in Lennar's Federal taxable income, the Company entered into a Tax Reimbursement Agreement on November 26, 2013, which was effective September 1, 2013, pursuant to which the Company will pay Lennar, each time the Company would be required to pay Federal or state income taxes if it were a taxable corporation, the sum equal to the Federal or state income tax the Company would have been required to pay if it and its subsidiaries were all taxable corporations, minus any Federal or state income taxes the Company or its subsidiaries actually pay. The Company will make such payment to Lennar 5 days prior to the date on which Lennar files applicable tax returns. This agreement will terminate if the Company is no longer a subsidiary of Lennar. As of February 28, 2014 and November 30, 2013, the Company has $7.5 million and $12.4 million, respectively, recorded as a liability to Lennar under this Tax Reimbursement Agreement on the accompanying consolidated balance sheets.

Prior to the 7.00% Senior Notes Offering – Prior to November 2013, cash funding had been provided by the Parent for operating capital on an as-needed basis. Excess operating funds generated by the Company and any cash distributions from unconsolidated entities had been swept back to Lennar. No interest had been charged for the use of funds provided by the Parent. All cash funding, net of amounts swept back to Lennar were recorded as Due to Parent for periods prior to November 2013.

16. NEW ACCOUNTING PRONOUNCEMENTS

In December 2011, the Financial Accounting Standards Board ("FASB") issued ASU 2011-11, *Disclosures about Offsetting Assets and Liabilities,* ("ASU 2011-11"), which requires entities to disclose information about offsetting and related arrangements of financial instruments and derivative instruments. In January 2013, this guidance was amended by ASU 2013-01, *Clarifying the Scope of Disclosures about Offsetting assets and Liabilities* ("ASU 2013-01"). ASU 2013-01 limits the scope of ASU 2011-11 to certain derivatives, repurchase and reverse repurchase agreements, and securities borrowing and lending transactions. The guidance is effective for the Company's fiscal year beginning December 1, 2013 and subsequent interim periods. The adoption of this guidance, which is related to disclosure only, did not have a material effect on the Company's consolidated financial statements.

In April 2013, the FASB issued ASU 2013-04, *Liabilities,* ("ASU 2013-04"). ASU 2013-04 provides guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation is fixed at the reporting date. ASU 2013-04 will be effective for the Company's fiscal year beginning December 1, 2014 and subsequent interim periods. The adoption of ASU 2013-04 is not expected to have a material effect on the Company's consolidated financial statements.

On June 7, 2013, the FASB issued ASU 2013-08, *Investment Companies,* ("ASU 2013-08). ASU 2013-08 amends the criteria for an entity to qualify as an investment company under ASC 946. While ASU 2013-08 is not expected to significantly change which entities qualify for the specialized investment company accounting in ASC 946, it (1) introduces new disclosure requirements that apply to all investment companies and (2) amends the measurement criteria for certain interests in other investment companies. ASU 2013-08 also amends the requirements in ASC 810 related to qualifying for the "investment company deferral" in ASU 2010-10 as well as the requirements in ASC 820 related to qualifying for the "net asset value practical expedient" in ASU 2009-12. ASU 2013-08 will be effective for the Company's second fiscal quarter beginning March 1, 2014. The adoption of ASU 2013-08 is not expected to have a material effect on the

Company’s consolidated financial statements.

In July 2013, the FASB issued ASU 2013-11, *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a similar Tax Loss, or a Tax Credit Carryforward Exists,* (“ASU 2013-11”). ASU 2013-13 is intended to end inconsistent practices regarding the presentation of an unrecognized tax benefits when a net operating loss ("NOL"), a similar tax loss or a tax credit carryforward is available to reduce the taxable income or tax payable that would result from the disallowance of a tax position. ASU 2013-11 will be effective for the Company’s fiscal year beginning December 1, 2014 and subsequent interim periods. The adoption of ASU 2013-11 is not expected to have a material effect on the Company’s consolidated financial statements.

17. SUBSEQUENT EVENTS

In connection with the preparation of the consolidated financial statements, the Company evaluated subsequent events occurring after the balance sheet date of February 28, 2014 through April 23, 2014, the date the consolidated financial statements were available to be issued, and concluded that no events, other than those described below, have occurred that required recognition or disclosure in the consolidated financial statements.

On March 26, 2014, $22.9 million was distributed by the two FDIC LLCs, of which $13.9 million was paid to the FDIC and $9.0 million was paid to the Company. On April 26, 2014, $11.0 million had been distributed by the LLCs, of which $6.6 million was paid to the FDIC and $4.4 million was paid to the Company. From inception to date, $133.8 million has been distributed by the LLCs, of which $80.3 million has been paid to the FDIC and $53.5 million has been paid to the Company.

During March 2014, Fund I distributed $40.0 million to its investors (including $4.4 million to us). Additionally, during April 2014, Fund I distributed $20.0 million to its investors (including $2.2 million to us). From inception to date, Fund I has distributed $480.5 million to its investors (including $52.5 million to us).

During March 2014, Fund II distributed $20.0 million to its investors (including $1.6 million to us). From inception to date, Fund II has distributed $45.0 million to its investors (including $3.5 million to us).

During March 2014, the Mezzanine Fund closed on additional equity commitments of approximately $43 million from both new and existing investors, bringing the total equity commitments to $125 million, including an increase in the Company’s commitment from $25.0 million to $27.3 million with $9.5 million remaining to be called from the Company. A total of $28.3 million in distributions was made to the Mezzanine Fund’s investors (including $8.7 million to us) as a result of new investors’ coming into the Mezzanine Fund. A total of $28.3 million was contributed to the Mezzanine Fund (including $1.5 million from us).

During April 2014, the Company executed an amendment to one of its warehouse repurchase facilities to temporarily increase the maximum borrowing capacity by $100 million to $350 million. This temporary $100 million increase will be in effect until the earlier of the closing of a securitization transaction or June 2, 2014. This affects the warehouse repurchase facility expiring October 8, 2015, and except for the temporary increase, each and every term of the facility remains in full force and effect.

The Company is currently in the process of issuing notes through a securitized structured note offering collateralized by certain assets originally acquired in the Bank Portfolios. The amount of the notes is approximately $73.8 million and net initial proceeds after costs and holdbacks for cash reserves is approximately $66.6 million. The notes were priced on April 25, 2014 with an annual rate of 2.85% and funding to the Company is expected to occur on May 8, 2014. The estimated final payment date for the notes is December 15, 2015.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our unaudited consolidated financial statements and accompanying notes included under Item 1 of this Report and our audited consolidated financial statements and accompanying notes included in our Annual Report for our fiscal year ended November 30, 2013.

Special Note Regarding Forward-Looking Statements

Some of the statements in this Management's Discussion and Analysis of Financial Condition and Results of Operations, and elsewhere in this Quarterly Report, are "forward-looking statements," as that term is defined in the Private Securities Litigation Reform Act of 1995. These forward-looking statements include statements regarding our business, financial condition, results of operations, cash flows, strategies and prospects. You can identify forward-looking statements by the fact that these statements do not relate strictly to historical or current matters. Rather, forward-looking statements relate to anticipated or expected events, activities, trends or results. Because forward-looking statements relate to matters that have not yet occurred, these statements are inherently subject to risks and uncertainties. Many factors could cause our actual activities or results to differ materially from the activities and results anticipated in forward-looking statements. These factors include those described under the caption "*Risk Factors*" in Item 1A of our Annual Report for our fiscal year ended November 30, 2013. We do not undertake any obligation to update forward-looking statements, except as required by Federal securities laws.

Outlook

During the first quarter of 2014, we continued our focus on raising investment capital from third party investors and have been able to produce profits by investing this third-party capital in real estate related assets. Focusing on managing real estate related investments more predominantly for third parties shifts the principal sources of our earnings from loan interest and net gains on sales of foreclosed real estate ("REO") resulting from direct investments towards a co-investments and investment management, asset management, and other servicing fees oriented business. We expect this focus to carry into the future. In addition, we have also supplemented our earnings with our Rialto Mortgage Finance business ("RMF") by originating and securitizing fixed rate commercial first mortgage loans, earning profits by selling the loans to securitization trusts for more than what we invest in them. In our Direct Investment business line, the limited liability companies in which we have invested along with the Federal Deposit Insurance Corporation ("FDIC") have continued to distribute capital in 2014. However, revenues and earnings from our direct investment in the FDIC LLCs and portfolios of mortgage loans we acquired from banks in 2011 will continue to decrease as the assets underlying these investments wind down.

Looking past 2014, we also expect our newly acquired hospital operation to see increased revenues and expenses as we work towards making it profitable. We also expect to grow our management fees and begin receiving performance based incentive fees ("carried interest") as the investments in our real estate funds are monetized in the future. We typically earn carried interest in the investment vehicles we sponsor when distributions in those vehicles exceed the amount the investors contributed plus specified threshold returns on the investors' capital. For the funds we have in place today, we estimate that carried interest would be distributed approximately six years after those vehicles begin investing. As we increase the number of our investment funds and our investment funds age, we anticipate an increasing portion of our revenues to be generated by carried interests.

If Fund I had ceased operations and liquidated all its investments for their estimated fair values on February 28, 2014, we would have received $90.2 million with regard to our carried interest for that fund. However, Fund I did not cease operations and liquidate its investments on February 28, 2014, and the actual sum we receive with regard to our carried interest in Fund I may be substantially higher or lower than $90.2 million. No amount has been accrued in our consolidated statement of operations with regard to our carried interest in Fund I or any other fund, although we did collect carried interest with respect to our Public-Private Investment Program fund ("PPIP Fund") which was substantially realized in 2012. See Note 2, Basis of Presentation in the notes to the unaudited consolidated financial statements for more information about how we record revenues attributable to Carried Interest.

With a number of institutions no longer in the real estate lending business, and those remaining facing stricter underwriting standards and new government-imposed regulations, we anticipate a large scale opportunity to originate commercial first mortgage loans as a significant component of the existing commercial real estate loan universe matures and must be refinanced. In addition, many financial institutions remain burdened by exposure to overleveraged real estate assets and must further deleverage their balance sheets before they can significantly increase new originations. Lenders have utilized distressed asset sales to rid themselves of these non- and sub-performing assets and have employed more conservative underwriting standards for new loans as they attempt to transition away from riskier assets. In addition, these lenders have been limited by regulators as to how much they can lend at a time when borrowers are searching for additional proceeds to refinance their upcoming maturities. As a result, we believe there is a growing opportunity for us to grow our senior lending business as well as our mezzanine lending and equity investing businesses.

Throughout the recent financial disruption, lending institutions benefitted from extensive accommodations from bank regulators, enabling loan restructuring practices that delayed a large portion of the necessary asset clearing and refinancing. Recent regulatory attention (e.g., Basel III and the U.S. Dodd Frank Wall Street Reform and Consumer Protection Act, including the so-called "Volcker Rule") has motivated many financial institutions more recently to implement more stringent bank capital standards, which we believe should create more of these opportunities.

Overview

We are a leading commercial real estate investment, investment management, and finance company focused on raising, investing and managing third party capital, originating and securitizing commercial mortgage loans, as well as investing our own capital through our investment vehicles in real estate related mortgage loans, properties and related securities. We have a vertically-integrated operating platform consisting of over 400 professionals located in ten offices across the U.S. We were founded in 2007 and are a wholly-owned subsidiary of Lennar Corporation ("Lennar" or "Parent"), one of the largest homebuilders in the U.S. At February 28, 2014, Lennar had $541 million of capital invested in our business to support our growth.

We apply a comprehensive risk management approach across our business lines, which is rooted in our management's deep understanding of fundamental real estate values and proven ability to manage these complementary business lines through multiple economic and credit cycles. To date, many of our investment and management opportunities have arisen from the dislocation in the U.S. real estate markets from 2007 to 2010 and the efforts to restructure and recapitalize those markets. Going forward, we believe that we are well-positioned to capitalize on the opportunities arising from the diminished supply of commercial real estate capital and the substantial demand for new financings in the commercial real estate sector. We believe our experienced management team of industry veterans supplemented by Lennar's knowledge of regional and local real estate conditions in many parts of the country, will allow us to continue to grow our business prudently as we endeavor to capitalize on opportunities in the real estate investment and finance markets.

Results of Operations

Financial information relating to our operations for the three months ended February 28, 2014 and 2013, was as follows:

	Three Months Ended February 28, 2014	Three Months Ended February 28, 2013
REVENUE:		
Interest income	$ 18,462	$ 19,309
REO revenue:		
Hospital revenues	16,947	-
Rental income	5,864	4,542
Management fees	15,664	6,313
Gains from securitizations and other loan origination revenues	12,828	-
Total revenue	69,765	30,164
EXPENSES:		
General and administrative expense	24,354	12,574
REO expense, net:		
Hospital expense	19,308	-
Other REO expense, net	4,732	3,215
Provision for loan losses	6,716	7,090
Interest expense	6,409	1,317
Servicing expense	6,260	9,486
Securitization and loan origination expenses	2,734	-
Amortization of debt issuance costs	581	1,141
Depreciation expense	521	163
Total expenses	71,615	34,986
EQUITY IN EARNINGS FROM UNCONSOLIDATED ENTITIES	5,354	6,173
NET EARNINGS (INCLUDING NET EARNINGS (LOSS) ATTRIBUTABLE TO NONCONTROLLING INTERESTS)	3,504	1,351
LESS: NET EARNINGS (LOSS) ATTRIBUTABLE TO NONCONTROLLING INTERESTS	935	(328)
NET EARNINGS ATTRIBUTABLE TO RIALTO BEFORE PROVISION FOR INCOME TAXES	2,569	1,679
PROVISION FOR INCOME TAXES	988	667
NET EARNINGS ATTRIBUTABLE TO RIALTO	$ 1,581	$ 1,012

Three Months Ended February 28, 2014 versus Three Months Ended February 28, 2013

In the first quarter of 2014, net earnings before provision for income taxes was $2.6 million (which included $3.5 million of net earnings offset by $0.9 million of net earnings attributable to noncontrolling interests), compared to net earnings before provision for income taxes of $1.7 million (which included $1.4 million of net earnings and an add back of $0.3 million of net loss attributable to noncontrolling interests) in the same period last year. In the first quarter of 2014, revenues were $69.8 million, which consisted primarily of gains from securitizations and other revenue from our RMF business of $12.8 million, interest income primarily associated with our portfolio of real estate loans of $18.5 million, fees for managing and servicing assets of $15.7 million, rental income of $5.9 million and hospital revenues of $16.9 million, compared to revenues of $30.2 million in the same period last year, which consisted primarily of interest income associated with our portfolio of real estate loans of $19.3 million, fees for managing and servicing assets of $6.3 million and rental income of $4.5 million. Revenues increased primarily due to the new streams of revenue from our RMF business as well as revenue from the hospital acquisition that occurred during November 2013, slightly offset by our lower interest income as a result of a decrease in the portfolio of loans we own. In the first quarter of 2014, expenses were $71.6 million, which consisted primarily of costs related to our RMF business, loan portfolio operations, hospital expenses, provision for loan losses of $6.7 million ($9.7 million of impairments offset by $3.0 million of recoveries) primarily associated with the business line's FDIC loan portfolio (before noncontrolling interests) and other general and administrative expenses. Included in expenses is our REO operations of $4.7 million, which consisted primarily of expenses related to owning and maintaining REO of $11.9 million and net REO impairments of $2.3 million, partially offset by realized gains on the sale of REO of $9.5 million. This compares with expenses of $35.0 million in the same period last year, which consisted primarily of costs related to our portfolio operations, provision for loan losses of $7.1 million primarily associated with the FDIC loan portfolio (before noncontrolling interests), and other general and administrative expenses. That included expenses of our REO operations of $3.2 million, which consisted primarily of expenses related to owning and maintaining REO of $12.6 million and REO impairments of $0.8 million, partially offset by realized gains on the sale of REO of $8.7 million. Expenses increased primarily due to securitization expenses and hospital expenses that did not exist in the prior year quarter, general and administrative expenses related to our RMF business and an increase in interest expense related to the issuance of the 7.00% Senior Notes in the fourth quarter of 2013.

In the first quarter ended February 28, 2014, we had equity in earnings from unconsolidated entities of $5.4 million, which primarily included $5.1 million of our share of earnings from Fund I. Equity in earnings from unconsolidated entities was $6.2 million in the same period last year, which included $6.4 million of equity in earnings related to the our share of earnings from Fund I.

In 2013, we formed our RMF business line, which originates and securitizes five, seven and ten year commercial fixed rate first mortgage loans on stabilized cash flowing properties. Generally those loans are between $2 and $75 million in size. During the three months ended February 28, 2014, we originated loans with a total principal balance of $295.5 million and sold $253.0 million of these loans into two separate securitization trusts. As of February 28, 2014, we had an additional $49.2 million in originated loans that were transferred to receivables, net as they had been sold into a third securitization trust but had not been settled as of the balance sheet date. Additionally, as of February 28, 2014, we had two warehouse repurchase facilities that mature in 2015 totaling $500 million to use in our RMF business, of which, $57.8 million was outstanding.

During 2013, the LLCs we own in partnership with the FDIC finished repaying the $627 million of loans from the FDIC ahead of schedule and thus, were able to start distributing capital back to investors. During the three months ended February 28, 2014, $53.1 million had been distributed by the LLCs, of which, $32.3 million was paid to the FDIC and $20.8 million was paid to us. From inception to February 28, 2014, $99.8

million has been distributed by the LLCs, of which $60.6 million was paid to the FDIC and $39.2 million was paid to us.

In 2014, the Company created the Rialto Capital CMBS Fund (the "CMBS Fund"). The general purpose of the CMBS Fund is to acquire, own and/or monetize commercial mortgage-backed securities with at least some portion of the collateral being originated by our RMF business.

Subsequent to quarter end, the Company issued an additional $100 million aggregate principal amount, as an add-on to the 7.00% Senior Notes, at a price of 102.25%, in a private placement. The terms from the add-on offering have identical terms as the 7.00% Senior Notes. Proceeds from the offering, after payment of expenses, were approximately $101.7 million. The Company intends to use most of the funds as additional working capital for its RMF business, in addition to funding contributions to its investment funds or for other general corporate purposes.

Business Lines

The Company operates in three business lines, Asset and Investment Management, RMF and Direct Investments in Real Estate Related Assets. Our business lines are identified based upon how management operates and manages our activities as well as the types of products sold and services performed.

Asset and Investment Management

We are the sponsor of and an investor in private funds and other investment vehicles that invest in and manage real estate related assets. In addition to receiving earnings on our investments, we also earn fees for our role as an investment manager and general partner of these vehicles and for providing investment management and other services to those vehicles and other third parties. As discussed in the Overview Section, these types of revenues are becoming increasingly important to us as we move away from using a greater portion of our own capital to invest in real estate and real estate related assets as we have done in our Direct Investments business line. We are instead focusing more on raising capital for investments and then earning revenue through management and servicing fees, as well as by participating in the ownership as a co-investor and earning carried interest after distributions to investors have met specified investment return thresholds. Carried interest on the funds in place today generally will not be received until those funds mature and a significant portion of the assets are monetized (estimated generally to be approximately six years after the inception of investing for most of our existing funds).

Fund I — In 2010, we completed the first closing of the Rialto Real Estate Fund, LP ("Fund I"), which had as its objective investing in distressed real estate assets and making other related investments that fit within its investment parameters. Fund I targeted a net internal rate of return exceeding 20% and a net cash flow multiple on invested equity exceeding 2.0x. Investors committed and contributed a total of $700 million of equity (including $75 million by us). All capital commitments have been called and funded, and Fund I is closed to additional commitments. As it was fully funded, there were no investor contributions during the three months ended February 28, 2014. For the three months ended February 28, 2014 and 2013, our share of earnings of Fund I were $5.1 million and $6.4 million, respectively. During the three months ended February 28, 2014 and 2013, the Company received distributions of $3.2 million and $7.7 million, respectively, as a return of capital. From inception to February 28, 2014, a total of $420.5 million in distributions, equal to over 60% of their invested capital, had been made to investors (including $45.9 million distributed to us).

If Fund I had ceased operations and liquidated all its investments at their estimated fair values on February 28, 2014, we would have received $90.2 million with regard to our carried interest. However, Fund I did not cease operations and liquidate its investments on February 28, 2014, and the ultimate sum we will receive with regard to our carried interest in Fund I may be substantially higher or lower than $90.2 million. No amount has been recorded in our consolidated statement of operations with regard to our carried interest in Fund I, although we did collect carried interest with respect to our PPIP Fund which was substantially realized in 2012. See Note 2, Summary of Significant Accounting Policies in the notes to the unaudited consolidated financial statements for more information on how we record revenues attributable to carried interests.

Fund II — In 2013, we conducted the first closing of commitments of our second real estate investment fund, Rialto Real Estate Fund II, LP ("Fund II"). Fund II's objective during its commitment period is to acquire and manage distressed and other value-add real estate assets and other related investments that fit Fund II's investment parameters (which are a targeted gross internal rate of return of 18% to 20%). Among other things, Fund II's documents prohibit us from directly acquiring real estate assets that meet the investment criteria of Fund II, before Fund II is fully invested or committed. As of February 28, 2014, Fund II was closed to additional commitments with equity commitments of $1.3 billion, including $100.0 million committed by us. As of February 28, 2014, $660.1 million of the $1.3 billion in equity commitments was called, of which we contributed our portion of $50.6 million. During the three months ended February 28, 2014, $148.6 million in equity commitments was called, none of which was called from us due to new investors coming in to Fund II. For the three months ended February 28, 2014, our share of earnings of Fund II was approximately zero.

Mezzanine Fund — In 2013, we began raising capital and investing in mezzanine commercial real estate loans (usually loans secured by the equity of the entity that owns real estate that is already subject to a first mortgage loan). These loans typically carry a higher interest rate than a first lien position commercial mortgage real estate loan. We created the Rialto Mezzanine Partners Fund, LP ("Mezzanine Fund") with a target of $300 million in equity commitments in what are expected to be cash flowing mezzanine commercial loans ranging in size from $3 million to $15 million. Our targeted gross internal rates of return for this fund range from 10% – 14%. As of February 28, 2014, the Mezzanine Fund had total equity commitments and capital invested of $82.0 million, including $25.0 million committed and invested by us. For the three months ended February 28, 2014, our share of earnings of the Mezzanine Fund was $0.3 million.

Managed Account — In 2013, we began managing a $200 million separate account for an insurance company that is investing in mezzanine loans that typically have lower loan to underlying collateral values.

CMBS Fund — In 2014, we created the CMBS Fund. The general purpose of the CMBS Fund is to acquire, own and/or monetize commercial mortgage-backed securities with at least some portion of the collateral being originated by our RMF business. As of February 28, 2014, the CMBS Fund had total invested capital of $14.7 million, including $9.7 million invested by us. As of February 28, 2014, the carrying value of our investment in the CMBS Fund was $9.7 million. For the three months ended February 28, 2014, our share of earnings of the CMBS Fund was approximately zero.

Other — In January 2014, we acquired 100% of the loan servicing business segment of a real estate services company in exchange for the approximately 5% investment we owned in that company as of November 30, 2013. This acquired operation had previously provided loan servicing support for our owned and managed portfolios, as well as asset management services for our small balance loan workout program. Prior to the acquisition, the Service Provider was included in the Direct Investments in Real Estate Related Assets business lines. As of November 30, 2013, the carrying value of our investment in the Service Provider was $8.3 million.

In addition to receiving distributions and carried interests with regard to funds we manage, we receive management fees from those funds, from the account we are managing for an insurance company and from the two LLCs we own in partnership with the FDIC. These fees are reflected in our consolidated statement of operations under the caption Management Fees, except that, because the revenues and expenses of the two FDIC LLCs are included in our consolidated financial statements, the management fees we receive from them are eliminated in consolidation (and instead reduce the minority interest in our net income). During the three month periods ended February 28 2014 and 2013, we received management fees that were reflected in our statements of operations totaling $15.6 million and $6.3 million. During those periods, we received management fees from the two FDIC LLCs totaling $2.1 million and $2.9 million, respectively. The management fees reflected on our statements of operations increased because of additional fund assets that were under management. The management fees from the two FDIC LLCs declined because of loan repayments, resolutions and other transactions that reduced the amount of LLC assets being managed.

RMF

During 2013, we created our RMF business to originate and securitize 5, 7 and 10 year fixed rate commercial first mortgage loans, generally with principal amounts between $2 million and $75 million, which are secured by income producing properties. As of November 30, 2013, we had secured two warehouse repurchase facilities, with total borrowing capacity of $500 million, for loan originations, and we are continuing to work to increase our warehouse line capacity with a number of other sources.

Our goal has been to securitize loans through third party issuers at least quarterly, thus keeping them on our balance sheet for a relatively short period of time. During the three months ended February 28, 2014, we originated loans with a total principal balance of $295.5 million and sold and closed $253.0 million of originated loans into two separate securitization trusts. An additional $49.2 million of originated loans were sold into a securitization trust but not yet closed as of February 28, 2014, and thus, the sale price of these loans was included in Receivables, net in the accompanying consolidated balance sheet.

Direct Investments in Real Estate Related Assets

We began making Direct Investments in Real Estate Related Assets in 2010, when the economy and housing sector were still performing poorly and had not yet started to recover. Because of this, we were able to purchase loan portfolios and real estate related assets at significant discounts. However, investing in assets of this type requires a concentrated use of our capital, and therefore, beginning in 2011, we began to focus more on raising third party capital to invest with us side-by-side and where we could utilize our expertise to increase our returns through the collection of fees and carried interest.

FDIC Portfolios — In February 2010, we acquired 40% managing member equity interests in two limited liability companies (“LLCs”) that had been formed by the LLC to hold performing and non-performing loans formerly owned by 22 failed financial institutions. The FDIC retained 60% equity interests in the LLCs and provided $626.9 million of financing with 0% interest, which was non-recourse to us and to the LLCs. When we acquired our interests in the two LLCs, their portfolios consisted of approximately 5,500 distressed residential and commercial real estate loans. The financing from the FDIC has been repaid and the two LLCs are now making distributions to members, of which we receive 40%.

Bank Portfolios — In September 2010, we acquired from three financial institutions portfolios consisting of a total of approximately 400 distressed commercial and residential mortgage loans and over 300 properties that had been obtained through foreclosures of loans. We paid $310 million for the distressed real estate and real estate related assets of which $124 million was financed through a 5-year senior unsecured loan provided by one of the selling institutions. Our hospital investment, discussed below, was acquired in a workout on a loan from one of these portfolios.

In November 2013, in settlement of a loan acquired as part of Bank Portfolios, we acquired the real estate and operating entity of a hospital (the "Hospital"). This transaction was the result of a Chapter 11 reorganization plan approved on November 7, 2013. The reorganization plan required us to make a $10 million cash investment that will be used to improve the hospital and emergency room facilities, provide for working capital requirements and begin to repay secured and unsecured court approved claims per the reorganization plan. The Hospital guaranteed the payment of bankruptcy administrative claims of approximately $17.5 million owed to three groups of secured and unsecured creditors. In return, we acquired 100% of the Hospital operating entity effective November 8, 2013. The Hospital is included in our consolidated financial statements as of February 28, 2014, and its operating results are included in our Consolidated Statement of Operations for the three months ended February 28, 2014.

The Company has contracted a third party hospital operating company (the "Third Party Operator") to operate and manage the hospital at a discount from their normal management fee in return for gradually acquiring an equity participation in the hospital operating company. Additionally, the confirmed reorganization plan exchanges a 20% equity interest in the entity that owns the Hospital's land and building for the administrative bankruptcy claims of several doctors who were original shareholders of the now defunct hospital. The distribution of this noncontrolling interest to these doctors was conditioned and subject to the validation of the administrative claims presented by them during bankruptcy. Furthermore after validation of the claims, any and all distributions will be in compliance with all State and Federal healthcare regulatory requirements. As of February 28, 2014, Rialto's healthcare attorney has not concluded the exact amount of the claims that will be allowed, therefore; the noncontrolling interest has not been distributed. Rialto has the right to withhold the distribution of this noncontrolling interest until all such requirements are satisfied.

Starting in 2014, the three secured creditor groups will receive payments totaling 75% of the Hospital's net income plus the discount on the fees to the hospital management company towards their claims, some of which bear interest of 0% to 5%. In addition, all excess cash flows beyond the scheduled payments to secured creditors must be used to accelerate payment in full of these claims. Neither we nor the hospital management company will receive any distribution from operations other than the reduced management fee until all three groups of secured creditors have been paid in full, which management of the hospital believes can occur within 2 to 3 years.

CMBS Investment — In 2010, we purchased approximately $43 million face amount of non-investment grade CMBS for $19.4 million, representing a 55% discount from par value.

Selected Business Line Financial and Operational Data

Business line financial and operational data does not include an allocated portion of the Company's general and administrative expense at the corporate level of $22.1 million as well as interest and other expenses of $6.2 million for the three months ending February 28, 2014. Not included in business line financial and operational data for the three months ending February 28, 2013, is general and administrative expense at the corporate level of $11.5 million as well as interest expense and other expenses of $0.2 million.

Asset and Investment Management

Overview

($ in thousands)	As of	
	February 28, 2014	November 30, 2013
Total Assets	$ 164,720	$ 145,701

	Three Months Ended	
	February 28, 2014	February 28, 2013
Revenue	$ 17,479	$ 6,313
Equity in earnings (loss) from unconsolidated entities	5,390	6,308
Net Earnings Before Income Taxes	22,869	12,621

Three Months Ended February 28, 2014 versus Three Months Ended February 28, 2013

Revenue increased 177% quarter over quarter in our Asset and Investment Management business line mainly due to an increase in management fees due to only managing Fund I in the first quarter of 2013 compared to managing Fund I, Fund II, the Mezzanine Fund and the CMBS Fund in the first quarter of 2014. This was also aided by our acquisition of the Service Provider in 2014 which contributed additional revenue that did not exist in the first quarter of 2013. Net earnings before income taxes increased mostly due to the increase in revenue however, this was slightly offset by a decrease in equity in earnings from our funds as Fund I decreased quarter over quarter.

RMF

Overview

($ in thousands)	As of	
	February 28, 2014	November 30, 2013
Total Assets	$ 225,514	$ 269,577

	Three Months Ended	
	February 28, 2014	February 28, 2013
Revenue	$ 14,898	$ -
Net Earnings Before Income Taxes	9,597	-

Three Months Ended February 28, 2014 versus Three Months Ended February 28, 2013

Our RMF business began operations in the second half of 2013 and thus, was not in operations during the first quarter of 2013. RMF had revenues of $14.9 million in the first quarter of 2014 due mostly to gains from two securitizations as well as interest income on the originated loans. Revenue was partially offset by costs of the two securitizations and general and administrative expenses to arrive at net earnings before income taxes of $9.6 million.

Direct Investments in Real Estate Related Assets

Overview

($ in thousands)	As of February 28, 2014	As of November 30, 2013
Total Assets	$ 939,588	$ 1,010,385

	Three Months Ended February 28, 2014	Three Months Ended February 28, 2013
Revenue	$ 38,838	$ 23,851
Net (Loss) Earnings Before Income Taxes	(1,613)	728

Three Months Ended February 28, 2014 versus Three Months Ended February 28, 2013

Revenue increased 63% quarter over quarter in our Direct Investments in Real Estate Related Assets business line due mostly to the operations of the hospital that was acquired at the end of 2013. This was aided by an increase in our rental income from REO and was slightly offset by a decrease in interest income as our portfolio of loans has decreased through loan collections, payoffs and REO conversions. Net earnings (loss) before income taxes decreased due to an increase in expenses related to the hospital. REO expenses also increased quarter over quarter however, these increase in expenses were slightly offset by a decrease in all other expenses.

Below is a summary of the business lines' financial results to arrive at the Company's consolidated financial results (in thousands):

	As of and for the Three Months Ended February 28, 2014					
	Asset and Investment Management	Loan Origination & Securitization	Direct Investments	Corporate	Eliminations	Total Consolidated
Total Assets	$ 164,720	$ 225,514	$ 939,588	$ 91,442	$ -	$ 1,421,264
Revenue	17,479	14,898	38,838	-	(1,450)	69,765
Net Earnings (Loss) Before Income Taxes	22,869	9,597	(1,613)	(28,284)	-	2,569

	As of November 30, 2013 and for the Three Months Ended February 28, 2013					
	Asset and Investment Management	Loan Origination & Securitization	Direct Investments	Corporate	Eliminations	Total Consolidated
Total Assets	$ 145,701	$ 269,577	$ 1,010,385	$ 53,650	$ -	$ 1,479,313
Revenue	6,313	-	23,851	-	-	30,164
Net Earnings (Loss) Before Income Taxes	12,621	-	728	(11,670)	-	1,679

Financial Condition and Capital Resources

Liquidity – February 28, 2014

At February 28, 2014, we had approximately $169.4 million in cash.

Our notes payable and other debts payable consisted of the following at February 28, 2014 and November 30, 2013 (in thousands):

	February 28, 2014	November 30, 2013
Senior Notes	$ 250,000	$ 250,000
Bank Portfolios	90,933	90,933
Warehouse repurchase facilities	57,848	76,017
Notes payable - other	22,977	24,933
Total Notes payable and other debts payable	$ 421,758	$ 441,883

The Bank Portfolios' notes payable have an interest rate of the higher of 4.5% or 1 month LIBOR plus 3.75%. The warehouse repurchase facilities' interest rate is the higher of 2.5% or 1 month LIBOR plus 2.25%. The 7.00% Senior Notes bear interest at 7%. Other notes payable have interest rates ranging from 0.0% to 6.9%.

In January 2014, the Company extended the maturity date of the Bank Portfolio's note payable from September 30, 2013 to September 30, 2016. Additionally, in February 2014, the Company rescheduled the three remaining principal payments of $30.3 million to be due on December 15, 2014, 2015 and 2016.

The first $250 million warehouse loan facility originated during 2013 has a maturity date of August 9, 2015 with an option for a one time, one year extension. The second $250 million warehouse loan facility originated during 2013 has a maturity date of October 8, 2015 with an option for a one time, one year extension. These facilities are in the form of two separate repurchase agreement lines, and each of them is secured by the loans that are funded with it. The borrowings are repaid with proceeds from the sales of loans into securitizations. The interest rate on both the facilities is at one month LIBOR plus 2.25% (with a one month LIBOR floor of 0.25%) and is calculated on the principal amount that is outstanding from time to time. Interest on the 7.00% Senior Notes is due semi-annually beginning June 1, 2014.

Prior to our issuance of the 7.00% Senior Notes, our Asset and Investment Management business line and our Direct Investments business line were funded largely by Lennar. Our RMF business is funded by our two warehouse repurchase facilities and the proceeds of the sale of the 7.00% Senior Notes in excess of the $100 million that was paid to Lennar. As a result of the 7.00% Senior Notes offering, we have become substantially self-sustaining, and we will request funding from Lennar only to the extent, if any, it is required to supplement our own resources (which Lennar has no obligation to provide, aside from up to $75 million we can borrow under a Revolving Credit Agreement Lennar entered into in 2013). During 2013, we repaid $235 million that Lennar had provided to us (including the $100 million repaid with proceeds of the sale of the 7.00% Senior Notes). After that repayment, the remaining capital Lennar had invested in us, which all is in the form of equity, was $541.0 million as of February 28, 2014. As we receive proceeds of the winding down of the FDIC LLCs and our Bank Portfolios, we expect to return at least a portion of Lennar's remaining investment.

Subsequent to quarter end, we issued an additional $100 million aggregate principal amount, as an add-on to the 7.00% Senior Notes, at a price of 102.25%, in a private placement. The terms from the add-on offering have identical terms as the 7.00% Senior Notes. Proceeds from the offering, after payment of expenses, were approximately $101.7 million. The Company intends to use most of the funds to provide additional working capital to its RMF business, in addition to funding contributions to its investment funds or for other general corporate purposes.

During 2013, Lennar entered into a Revolving Credit Agreement with us under which, subject to customary lending conditions, Lennar will at any time make advances to us on a revolving basis up to a maximum of $75 million. The revolving facility will terminate in November 2015. Borrowings bear interest at LIBOR plus 3.5%. At February 28, 2014, no amounts had been borrowed or repaid under this agreement.

Cash Flows

Cash provided by (used in) our operating, investing and financing activities is summarized as follows:

($ in thousands)	February 28, 2014	February 28, 2013
Operating activities	$ (19,486)	$ (25,241)
Investing activities	40,210	272,393
Financing activities	(52,816)	(288,274)
Total cash flows	$ (32,092)	$ (41,122)

Operating Cash Flow Activities

During the three months ended February 28, 2014 and 2013, cash used in operating activities totaled $19.5 million and $25.2 million, respectively, representing a 23% improvement quarter over quarter. Cash used in operating activities was impacted largely by our new RMF business that used cash for loan originations of $295.5 million partially offset by the sale of a portion of those loan originations into two separate securitization trusts for a cash inflow of $203.8 million net of the amount or originated loans transferred to Receivables, net. There was a decrease in accruals and other liabilities of $13.9 million, a decrease in due to Parent of $5.0 million and an increase in other assets of $6.9 million. These cash uses were offset by $111.8 million of loans settled during the quarter and net earnings attributable to Rialto of $1.6 million. Included in net earnings attributable to Rialto were non-cash items such as realized gains on the sale of REO of $9.5 million. Other cash used in operating activities amounted to $14.1 million.

During the three months ended February 28, 2013, cash used in operating activities totaled $25.2 million. These cash uses were slightly offset by net earnings attributable to Rialto of $1.0 million. Included in net earnings attributable to Rialto were non-cash items such as realized gains on the sale of REO of $8.7 million

Investing Cash Flow Activities

During the three months ended February 28, 2014 and 2013, cash provided by investing activities was $40.2 million and $272.4 million, respectively, representing an 85% decrease quarter over quarter. Cash provided by investing consisted of receipts of principal payments on our loans receivable, net of $6.9 million, proceeds from the sale of REO of $50.7 million and return of capital from unconsolidated entities of $5.2 million. This was slightly offset by an $18.3 million contribution to our investments in unconsolidated entities and other uses of cash of $4.3 million.

During the three months ended February 28, 2013, cash provided by investing activities totaled $272.4 million. Cash provided by investing consisted of receipts of principal payments on our loans receivable, net of $18.4 million, proceeds from the sale of REO of $34.5 million, return of capital from unconsolidated entities of $7.7 million and a decrease in our defeasance cash of $219.2 million due to the paydown of the FDIC Notes. This is slightly offset by other uses of cash of $7.3 million.

Financing Cash Flow Activities

During the three months ended February 28, 2014 and 2013, cash used in financing activities was $52.8 million and $288.3 million, respectively, representing an 82% improvement quarter over quarter. Cash used in financing consisted of the paydown of the Notes payable of $2.1 million, distributions to the FDIC of $32.3 million and net payments under the warehouse repurchase facilities of $18.2 million. Other cash used in financing amounted to $0.2 million.

During the three months ended February 28, 2013, cash used in financing activities totaled $288.3 million. Cash used in financing consisted of the paydown of the FDIC Notes of $304.1 million. This was offset by an increase in due to Parent of $15.8 million due to cash funding provided by Lennar.

Off-Balance Sheet Arrangements

Investments in Unconsolidated Entities

Financial information on a consolidated 100% basis regarding unconsolidated entities in which we have investments that are accounted for by the equity method was as follows as of February 28, 2014 and November 30, 2013, and for the three months ended February 28, 2014 and 2013 (in thousands):

Balance Sheets	February 28, 2014	November 30, 2013
Assets:		
Cash and cash equivalents	$ 234,811	$ 332,968
Loans receivable	585,271	523,249
Real estate owned	321,928	285,565
Investment securities	436,234	381,555
Investments in partnerships	238,935	149,350
Other assets	28,415	191,624
	$ 1,845,594	$ 1,864,311
Liabilities and equity:		
Accounts payable and other liabilities	$ 30,725	$ 108,514
Notes payable	317,306	398,445
Partner loans	-	163,940
Equity	1,497,563	1,193,412
	$ 1,845,594	$ 1,864,311

Statements of Operations	Three Months Ended February 28, 2014	February 28 2013
Revenues	$ 31,427	$ 53,343
Costs and expenses	26,109	59,114
Other income (expense) - net [(1)]	48,170	56,001
Net earnings of unconsolidated entities	$ 53,488	$ 50,230
Equity in earnings (loss) from unconsolidated entities	$ 5,354	$ 6,173

[(1)] Other income – net for the three months ended February 28, 2014 and 2013, includes Fund I and Fund II's realized and unrealized gains on investments as well as other income from REO. Other income - net for the three months ended February 28, 2013, includes the PPIP Fund's mark-to-market unrealized gains and losses, of which the Company's portion was a small percentage. Also includes Fund I's realized and unrealized gains on investments as well as other income from REO.

Contractual Obligations and Commercial Commitments

The following table summarizes certain of our contractual obligations at February 28, 2014:

		Payments Due by Period			
	Total	Less than 1 year	1 to 3 years	3 to 5 years	More than 5 years
Notes payable and other debts payable [(1)]	$ 363,910	$ 6,259	$ 74,970	$ 282,635	$ 46
Warehouse repurchase facilities [(2)]	57,848	57,848	-	-	-
Interest commitments under interest bearing debt [(3)]	93,053	17,377	40,468	35,187	21
Investment commitments [(4)]	49,421	49,421	-	-	-
RMF rate lock commitment [(5)]	51,700	51,700	-	-	-
Operating leases	9,732	1,148	3,825	4,759	-
Total contractual obligations	$ 625,664	$ 183,753	$ 119,263	$ 322,581	$ 67

[(1)] Subsequent to quarter end, the Company issued an additional $100 million aggregate principal amount, as an add-on to the 7.00% Senior Notes. This amount is not included in table above.

[(2)] Warehouse facilities are assumed to be paid off in the short term as soon as loans held-for-sale are securitized, which is normally within 2 to 3 months.

[(3)] Interest commitments on variable interest bearing debt are determined based on the interest rate as of February 28, 2014

[(4)] Amount includes the Company's capital commitments to Fund II.

[(5)] Relates to two loans the Company is contractually obligated to fund but has yet to release the funds to the borrower.

New Accounting Pronouncements

See Note 16 of our consolidated financial statements included under Item 1 of this Report for a discussion of new accounting pronouncements applicable to our Company.

Critical Accounting Policies and Estimates

We believe that there have been no significant changes to our critical accounting policies and estimates during the three months ended February 28, 2014, as compared to those we disclosed in Managements' Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report for the year ended November 30, 2013 other than those disclosed below.

Goodwill – Goodwill represents the excess of the purchase price paid over the fair value of the net assets acquired. Evaluating goodwill for impairment involves the determination of the fair value of our reporting unit in which we have recorded goodwill. A reporting unit is a component of a business line for which discrete financial information is available. Inherent in the determination of fair value of our reporting unit is certain estimates and judgments, including the interpretation of current economic indicators and market valuations as well as our strategic plans with regard to our operations. To the extent additional information arises or our strategies change, it is possible that our conclusion regarding goodwill impairment could change, which could have a material effect on our financial position and results of operations.

The Company recorded goodwill in connection with an acquisition during the first quarter of 2014 (see Note 7) and is recorded in Other assets – net in the consolidated balance sheets. Because the acquisition happened during the first quarter of 2014, there has been no annual review of goodwill as of February 28, 2014, with the first annual review of goodwill planned in the fourth quarter of 2014, unless indicators for impairment exist in earlier periods.

Hospital Revenue - We recognize revenues from the Hospital operation acquired in 2013 in the period in which services are provided. Amounts we receive for treatment of patients covered by governmental programs, such as Medicare and Medicaid, and other third-party payers such as HMOs, PPOs and other private insurers, are generally less than our established billing rates. Revenues are recorded at estimated net amounts due from patients, third-party payers and others for healthcare services provided. Accordingly, revenues are reduced to net realizable value through an allowance for contractual discounts. For certain payers, such as Medicare, Medicaid, as well as some managed care payers with which we have contractual arrangements, the contractual allowances are calculated by computerized logging systems based on defined payment terms. For other payers, the contractual allowances are determined based on historical data by insurance plan. All contractual adjustments, regardless of type of payer or method of calculation, are reviewed and compared to actual experience.